

## **Section II**

# **Financial Statement Findings**

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# Department of Agriculture

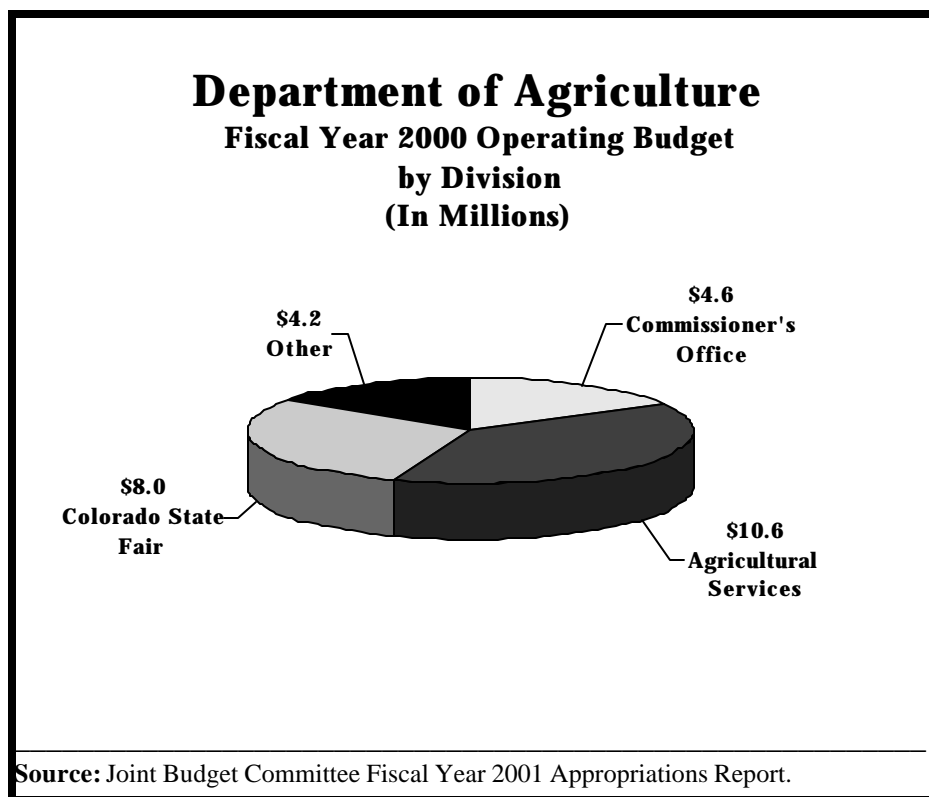
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## Introduction

The Department of Agriculture is responsible for regulating, promoting, and supporting agricultural activities throughout Colorado. The Department performs services including policy formulation, data collection, program inspection, consumer information, and regulation of the State's agricultural industries. In addition, it administrates and manages the State Fair, whose audit is discussed in a separate report. The Department of Agriculture includes the following divisions:

- C Commissioner's Office and Administrative Services
- C Agricultural Services Division
- C Agricultural Markets Division
- C Brand Board
- C Colorado State Fair

The Department of Agriculture was appropriated \$27.4 million and 285.6 full-time equivalent staff (FTE) for Fiscal Year 2000. Approximately 30 percent of the funding is from general funds, 68 percent is from cash funds, and 2 percent is from federal funds. The following chart shows the operating budget by division during Fiscal Year 2000.



## **Performance Evaluations Need to Be Conducted**

Section 24-50-118, C.R.S., requires that certified state employees in the Executive Branch be evaluated on their performance annually. The evaluation is to be used as a factor in determining compensation, promotions, demotions, and terminations. A supervisor within the state personnel system who does not perform annual evaluations of his/her subordinates is to be suspended from work without pay for a period of at least one work week.

During our audit we found problems in our review of 25 performance evaluations. Three performance evaluations were at least three months late, one of which had not been completed since 1991. Without performance evaluations, employees are not provided the opportunity to discuss their performance and make improvements if necessary.

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### **Recommendation No. 1:**

The Department of Agriculture should ensure that all employees receive a timely annual performance evaluation.

#### **Department of Agriculture Response:**

Agree. The Department of Agriculture will have performance evaluations completed annually for employees. This will be implemented by July 2001.

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## **Ensure Review of Payroll Information**

The Department of Agriculture maintains a personnel file for each employee. The file should contain a signed W-4 indicating the level of taxes the employee instructs to be withheld, personnel action forms of approved changes in pay grade or job status, and benefit information. During our Fiscal Year 2000 audit we reviewed a sample of 25 personnel files and found the following problems with incomplete or missing information.

- Two W-4s did not indicate marital status, yet taxes were withheld at the married rate.
- One W-4 had conflicting exemptions. The top portions of the W-4 showed one allowance, but the bottom portion of the form totaling the allowances was blank. The Department did not follow up with the employee, but instead calculated the pay with no withholding exemptions.

The Department is not adequately reviewing information contained in employee personnel files. This could adversely affect employees and/or the Department. If taxes are withheld at a different rate than indicated on the W-4, the employee may be paid the incorrect amount and may unexpectedly owe taxes.

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## **Recommendation No. 2:**

The Department of Agriculture should improve its review of employee personnel files by verifying that withholding documentation is accurate and complete.

### **Department of Agriculture Response:**

Agree. The Department will require marital status and number of exemptions be filled out properly. The Department will follow up on uncompleted forms. The top portion of the W-4 is the employee's working copy and will not be filed in the employee's folder. This has already been implemented.

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# Department of Corrections

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## Introduction

The Department of Corrections manages the State's adult correctional facilities and the adult parole system. The Department also operates the Prison Canteens and the Division of Correctional Industries. The canteens provide various personal items for purchase by inmates, including toiletries, snack foods, and phone services. Correctional Industries operates furniture manufacturing facilities, computer manufacturing facilities, a leather products shop, metal fabrication shop, a print shop, various farming and ranching facilities, Colorado State forms production and distribution facilities, an automotive service station, and the State's license plate manufacturing facility. It also manages the State's surplus property.

The Department's Fiscal Year 2000 operating budget was approximately \$437 million with 5,338 full-time equivalent staff (FTE). Administrative offices for the Department are located in Cañon City and Colorado Springs. Correctional facilities are located throughout the State and include Buena Vista, Cañon City, Denver, Pueblo, Limon, Ordway, Delta, Rifle, Golden, and Sterling.

The following comment was prepared by the public accounting firm of Baird, Kurtz & Dobson, who performed audit work at the Department of Corrections.

## Improve Methodology for Estimating Accrued Inmate Health Care Costs and Examine Increased Costs

The Department of Corrections has contracted with Colorado Access, a third-party administrator, to administer healthcare services for inmates. Colorado Access has contracted with healthcare providers for such services and makes payments to these healthcare providers on behalf of the Department.

As of June 22, 2000, Colorado Access performed a lag analysis of the incurred but not reported (IBNR) claims for purposes of establishing a year-end accrual for unpaid healthcare costs. Colorado Access estimated the Department's total healthcare costs for

Fiscal Year 2000 to be \$13,664,000, of which \$11,047,000 has been paid as of June 30, 2000, according to the Department's accounting records. Using these amounts, the Department should have recorded a liability for unpaid healthcare costs as of June 30, 2000, in the amount of \$2,617,000. Department personnel believed, however, that Colorado Access's estimates were too high and recorded a liability in the amount of \$1,953,000, or \$664,000 less than the Colorado Access estimate of liability. Therefore, the actual estimated accrued liability recorded by the Department for unpaid healthcare costs as of June 30, 2000, was not determined using Colorado Access's methodology.

The analysis prepared by Colorado Access shows dramatic increases in inmate healthcare costs over the past two years. For the period ended June 30, 1998, representing 204,289 inmate months (i.e., one inmate for one month), the Department's average monthly costs per inmate for healthcare was \$50.59. For the year ended June 30, 1999, the average annual cost per inmate for healthcare was \$712.56. For the six months ended December 31, 1999, the average cost per inmate was \$403.03, or \$806.06 on an annualized basis. For the six months ended June 30, 2000, the average cost per inmate based on actual costs incurred to date, as well as remaining costs estimated by Colorado Access, was \$587.26, or \$1,174.53 on an annualized basis. A portion of these dramatic increases has been attributed to a more effective billing process at Denver General Hospital (DGH) beginning in early 2000; prior to 2000, some inmate patient charges were not captured resulting in lost revenue for DGH and lower expenses for the Department. It would appear that these cost increases have made it difficult for Colorado Access to estimate a liability as of June 30, 2000, that is acceptable to the Department.

We understand that the Department has recently engaged a consulting actuary firm to assist with an analysis of the Department's healthcare costs.

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### **Recommendation No. 3:**

The Department of Corrections should record a liability for its incurred but not reported claims which has been determined using an acceptable mathematical model that would be consistent from period to period. Any differences between the mathematically determined liability and the amounts recorded in the accounting records should be quantified and based on reliable and supportable data.

The Department of Corrections should also obtain an understanding of the recent increases in its healthcare costs, to identify potential opportunities for cost savings and, if appropriate, renegotiate contractual arrangements with the third-party administrator and healthcare providers.

### **Department of Corrections Response:**

Agree. The Department does agree that it should attempt to improve on its accounting estimates for inmate healthcare costs and is in the process of working with consultants to help improve on the estimation process as well as examine increased costs and potential cost savings measures. The Department anticipates completion of the medical cost review and improved estimation process by June 30, 2001.

Due to a late revision of the estimated amount by the third-party administrator at fiscal year-end, the Department did not have confidence in the administrator's final estimate. The third-party administrator provided progressively increasing estimates for the fiscal year in the amounts of \$10.6 million, \$11.8 million, and \$13.7 million. The Department believed the final estimate was not reliable and modified the estimate using a combination of the last two estimates. The Department does monitor its estimates for accuracy and attempts to improve its estimation process on an ongoing basis. On the basis of a recent report dated October 10, 2000, by the third-party administrator, it appears that the recorded liability at June 30, 2000, was reasonable and an adequate estimate. The Department realizes that it is difficult to estimate the liability for the incurred but not recorded healthcare claims and that it is subject to unknown variables.

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# Department of Education

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## Introduction

Article IX of the Colorado Constitution places responsibility for the general supervision of the State's public schools with the Colorado State Board of Education (the Board). The Department of Education is directed by the Commissioner of Education and serves as the administrative arm of the Board, providing assistance to local education agencies and implementing administrative rules. The Department's mission is to "provide leadership and service to Colorado's education community and, through collaboration with this community, to promote high quality learning environments, high academic performance standards, and equitable learning opportunities for all Colorado's diverse learners."

- The Department's mission is carried out by the following units:
- Office of the Commissioner. Provides for state-level leadership of public education in Colorado, as well as the administrative support services of the Department.
- Educational Services. Develops and improves the administrative capabilities of local school districts, as well as provides for the accreditation process of the school districts.
- Management, Budget, and Planning. Manages all resources for the Department, both financial and human resources.
- Professional Services. Administers the Educator Licensing program and the Professional Education program for the Department.
- Special Services. Ensures the provision of services to traditionally under-served populations including low-income children, children with disabilities, migrant children, preschoolers and infants, and children at risk of dropping out of school or being expelled. Special Services also oversees the programs at the Colorado School for the Deaf and the Blind.
- State Library and Adult Education. Oversees programs that aim to provide leadership in adult education and library communities and to develop, promote, and deliver lifelong learning opportunities.



- Colorado School for the Deaf and the Blind. Provides comprehensive educational services to students who are deaf and/or blind.

The following comment was prepared by the public accounting firm of KPMG LLP, who performed audit work at the Department of Education.

## **Apply Methodology Consistently for Recording Year-End Expenditures**

During our audit we found that a \$1.5 million payment for contracted services was recorded in Fiscal Year 2001 based on an invoice received in late July 2000 by the Department. However, because the services were performed in February 2000, the expenditure should have been recorded in Fiscal Year 2000. Had the Department recorded the expenditure in the correct fiscal year, it would not have resulted in a budget overexpenditure.

Accounting standards require that expenditures be recorded in the period in which they were incurred. State agencies should be aware of outstanding expenditures for which they have not been billed.

The Department currently allows about three weeks after the end of a fiscal year for recording expenditures to the current period. In this instance, the invoice was received within the three-week period established by the Department. However, the Department did not record the \$1.5 million in the proper period, in violation of its own internal policy and accounting standards. Since the expenditure occurred in February, the Department should have followed up to obtain an invoice for payment well before year-end. The Department should follow its own internal policies so that expenditures are recorded in the proper period.

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### **Recommendation No. 4:**

The Department of Education should monitor the recording of expenditures at year-end to ensure that they are recorded in the proper period.

### **Department of Education Response:**

Agree. Transactions at fiscal year-end will be monitored to ensure expenditures are recorded in the correct fiscal year. Planned implementation is for the fiscal year ending June 30, 2001.

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# Department of Health Care Policy and Financing

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## Introduction

The Department of Health Care Policy and Financing (HCPF) is the state agency responsible for developing financing plans and policy for publicly funded health care programs. The principal programs administered by HCPF include the Medicaid program, which provides health services to eligible needy persons, and the Children's Basic Health Plan (CBHP), which furnishes subsidized health insurance for children 18 years or younger in low-income families not eligible for Medicaid. The Medicaid grant is the largest federal program administered by the State and is funded approximately equally by federal funds and state general funds. CBHP was implemented in Fiscal Year 1998, and it serves as the State's version of the federal Children's Health Insurance Program. CBHP is funded by approximately two-thirds federal funds and one-third state funds. It is marketed as Child Health Plan Plus, or CHP+. During Fiscal Year 2000 the Department expended in total almost \$2.09 billion and had 162 full-time equivalent (FTE) staff. In Fiscal Year 1999, HCPF expended \$1.91 billion and had 159 FTE.

The public accounting firm of Baird, Kurtz & Dobson (BKD) performed the audit work at HCPF as of and for the fiscal year ended June 30, 2000. During its audit BKD reviewed and tested HCPF's internal controls over financial reporting and federal programs, including compliance with certain state and federal laws and regulations as required by generally accepted auditing standards, Governmental Auditing Standards, and U.S. Office of Management and Budget (OMB) *Circular A-133*.

## Obtain Approval for Cost Allocation Plans

Under federal regulations, entities that receive federal awards may be reimbursed for a portion of indirect costs for the program. Indirect costs, or overhead costs, are those that benefit more than one program. One example of these costs is a staff person who performs accounting functions for multiple programs. To recover indirect costs, organizations must develop an annual cost allocation plan (CAP) that provides a reasonable and consistent basis for allocating indirect costs across the appropriate programs. The CAP must be prepared in accordance with federal guidelines, and it must

be submitted to and approved by the federal government. An approved CAP should be in place prior to the beginning of each fiscal year.

During the Fiscal Year 1998 and 1999 audits, it was noted that the Department did not have approved CAPs in place to allocate indirect costs, beginning with Fiscal Year 1995. Over the last several years, HCPF staff have worked to address this deficiency. During the Fiscal Year 2000 audit, we found that the Department had submitted and obtained approval for all CAPs through Fiscal Year 1999. The Department had not submitted a CAP for Fiscal Years 2000 or 2001.

The audit also found that in Fiscal Year 2000 the Department did not charge a share of indirect costs to CBHP until the end of the fiscal year. It would be more appropriate to charge CBHP for these costs on a periodic basis throughout the fiscal year as expenditures are incurred. Additionally, since there are limitations on federal reimbursements states may receive for administrative costs under programs like CBHP, it is important that the Department closely monitor these types of expenditures for CBHP.

## **Implementation of Additional Programs and Impact on Indirect Costs**

Without an approved cost allocation plan in place, the federal government could choose not to continue reimbursing the State for the federal share of indirect costs incurred by the Department, or the federal government could require that indirect costs previously reimbursed be repaid. This would drastically increase the cost to the State for operating the Medicaid program. Accordingly, the entire federal share of indirect costs claimed under the Medicaid and Medicaid-related programs for Fiscal Year 2000 in the amount of \$2,228,455 is questioned as to its appropriateness. (CFDA Nos. 93.777, 93.778—Medicaid Cluster—Allowable Costs (Cost Allocation Plan).)

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### **Recommendation No. 5:**

The Department of Health Care Policy and Financing should complete cost allocation plans for Fiscal Years 2000 and 2001 and submit them to the federal Health Care Financing Administration. The Department should ensure that approved plans are in place prior to the beginning of the fiscal year. Additionally, the Department should develop a method to periodically allocate indirect costs between Medicaid and the Children's Basic Health Program during the fiscal year.

## **Department of Health Care Policy and Financing Response:**

Agree. The Department has invested a significant amount of time and effort over the last 18 months to gain federal approval of the five cost allocation plans for State Fiscal Years 1995 through 1999. We will continue to prioritize the effort to become current, which will occur no later than June 30, 2001. It must be understood that with the approval of the cost allocation plan for State Fiscal Year 1999, we now have a federally approved cost allocation methodology. For Fiscal Years 2000 and beyond, we will simply be reporting the results of the allocations that occur as a result of the approved methodology. This will be reported to the federal government on a quarterly basis. Thus, there will be at least a quarterly allocation of indirect costs to the various programs administered by the Department.

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# Department of Higher Education

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## Introduction

The Department of Higher Education was established under Section 24-1-114, C.R.S., and includes all public education institutions in the State. It also includes the Auraria Higher Education Center, the Colorado Commission on Higher Education, the Colorado Council on the Arts, the Colorado Student Loan Division, the Colorado Historical Society, and the Division of Private Occupational Schools.

State public institutions of higher education are governed by six different boards. The governing boards and the schools they oversee are:

- **Board of Regents of the University of Colorado**  
University of Colorado at Boulder  
University of Colorado at Colorado Springs  
University of Colorado at Denver  
Health Sciences Center
- **State Board of Agriculture - Colorado State University System**  
Colorado State University  
Fort Lewis College  
University of Southern Colorado
- **Trustees of the State Colleges of Colorado**  
Adams State College  
Mesa State College  
Metropolitan State College of Denver  
Western State College  
Western Colorado Graduate Center
- **State Board for Community Colleges and Occupational Education (SBCCOE)**  
14 Community Colleges
- **Trustees of the University of Northern Colorado**  
University of Northern Colorado
- **Trustees of the Colorado School of Mines**  
Colorado School of Mines

## **Board of Regents of the University of Colorado**

The Board of Regents is constitutionally charged with the general supervision of the University and the exclusive control and direction of all funds of and appropriations to the University, unless otherwise provided by law. The University consists of four campuses: Boulder, Health Sciences Center, Denver, and Colorado Springs, as well as central administrative offices. Within the four campuses, 16 schools and colleges offer more than 140 fields of study at the undergraduate level and 100 fields at the graduate level.

## **University of Colorado**

The University of Colorado was established on November 7, 1861, by Act of the Territorial Government. Upon the admission of Colorado into the Union in 1876, the University was declared an institution of the State of Colorado, and the Board of Regents was established under the State Constitution as its governing authority.

The following comment was prepared by the public accounting firm of KPMG LLP, who performed work at the University of Colorado.

## **Processes for Fixed Assets Records Maintenance at the University of Colorado at Colorado Springs Should Be Improved**

The University of Colorado at Colorado Springs (UCCS) owns numerous equipment items ranging from computers to research equipment, which are tracked in a campus-developed fixed asset system. The UCCS equipment balance was \$22,553,000 at June 30, 2000. Historically, Physical Plant, under the Vice Chancellor for Finance and Administration, has been responsible for capital equipment at UCCS. Physical Plant's primary responsibilities include maintaining buildings and grounds. However, it is also responsible for capital asset record keeping, disposal of surplus equipment, and coordinating an annual inventory. These functions are critical to ensuring proper safeguarding of UCCS assets, accurate and complete financial reporting of capital assets, and compliance with applicable laws and regulations relating to capital equipment.

Federal regulations require institutions of higher education to follow the provisions of *OMB Circular A-110*. Basically, the *A-102 Common Rule* and *OMB Circular A-110* require

that equipment be used in the program which acquired it or, when appropriate, other federal programs. Equipment records shall be maintained, a physical inventory of equipment shall be taken at least once every two years and reconciled to the equipment records, an appropriate control system shall be used to safeguard equipment, and equipment shall be adequately maintained. When equipment with a current per unit fair market value in excess of \$5,000 is no longer needed for a federal program, it may be retained or sold with the federal agency's having a right to a proportionate (percentage of federal participation in the cost of the original project) amount of the current fair market value. Proper sales procedures shall be used that provide for competition to the extent practicable and result in the highest possible return.

We noted that the UCCS did not maintain accurate and complete capital equipment records. Specifically, records could not be located supporting assets that were disposed of in Fiscal Year 2000. The UCCS did not record fixed asset disposals for Fiscal Year 2000 in the financial accounting records. Equipment purchases and transfers among departments were inconsistently tagged and input into the campus asset tracking system. Due to the lack of processes in place to maintain capital equipment records, there is an increased risk that the University's assets are not safeguarded and maintained in accordance with applicable federal, state, and University regulations.

The UCCS should examine its processes relating to capital equipment. Specifically, the UCCS should ensure that accurate and complete inventory records are maintained, annual inventories are completed, and applicable laws and regulations are followed.

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## **Recommendation No. 6:**

The University of Colorado at Colorado Springs should strengthen its processes over fixed assets to ensure such assets are safeguarded, records are maintained, and disposals are handled in accordance with applicable federal, state, and University guidelines.

## **University of Colorado Response:**

Agree. The campus will strengthen its processes over fixed assets to ensure compliance with federal, state, and University guidelines. The responsibility for fixed asset recording and control, which currently lies with the Physical Plant Department, will be moved to the campus Accounting Office. The duties associated with this function will be assigned to the plant fund accountant. The plant fund accountant will adjust and reconcile asset records for Fiscal Year 2000,

as well as review current procedures and implement changes to ensure proper control in the future. Implementation will be completed by March 2001.

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## **Trustees of the State Colleges of Colorado**

The Board of Trustees of the State Colleges in Colorado (State Colleges) is the governing board for Adams State College, Mesa State College, Metropolitan State College of Denver, Western State College, and the Western Colorado Graduate Center. The Board of Trustees has oversight responsibilities for the four state colleges and the Graduate Center in the areas of finance, resources, academic programs, admissions, role and mission, and personnel policies.

## **Metropolitan State College of Denver**

Metropolitan State College of Denver serves a student population in the greater metro Denver area. Section 23-54-101, C.R.S., provides that Metropolitan State College of Denver be a comprehensive baccalaureate institution with modified open admission standards.

The following comment and recommendation was prepared by the public accounting firm of Kunder and Associates, P. C., who completed audit work at Metropolitan State College of Denver.

### **Improve Procedures Over Monitoring Grant Expenditures**

We noted that Metropolitan State College of Denver overcharged the Rocky Mountain Teacher Education Collaborative grant (CFDA No. 47.076) \$37,112 during the year ended June 30, 2000. The overcharge related to salaries and benefits of individuals whose time was charged to the grant based on an allocation of their time and effort. The allocation percentage carried forward from the prior year did not accurately reflect the time and effort of these individuals during the current year. The change in the allocation percentage was not timely communicated to the payroll department and, therefore, continued to be charged to the program at the previous rate. In addition, the overcharge was not detected by the Principal Investigator or Accounting Services due to the lack of



detailed information available in the Banner accounting system, which prevented an adequate review of the charges to the program. The overcharge was subsequently identified by the pass-through entity, the University of Northern Colorado, and will be corrected by reducing future charges to the grant in the amount of the overcharge.

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### **Recommendation No. 7:**

Metropolitan State College of Denver should improve procedures over monitoring grant expenditures as follows:

- a. Detailed information of charges to federal awards should be prepared or obtained by the Principal Investigator and Accounting Services to facilitate the review process.
- b. The Principal Investigator and Accounting Services should perform monthly reviews of charges to federal grants to ensure that the charges are proper and do not exceed budget guidelines.
- c. Changes in the grant program, including personnel time, should be communicated to the appropriate department (e.g., payroll, accounting) in a timely manner.

### **Metropolitan State College of Denver Response:**

Agree. Metropolitan State College of Denver will begin developing additional reports to assist the Principal Investigator and Accounting Services staff in the review process. In addition, Accounting Services staff will work more closely with the Principal Investigators on a monthly basis to ensure that the Principal Investigators understand their reports and that any problems/issues are addressed in a timely manner.

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## **Western State College**

Western State College is an undergraduate college of liberal arts and sciences. Section 23-56-101, C.R.S., provides that Western State College be a general baccalaureate institution with moderately selective admission standards.

The following comment and recommendation was prepared by the public accounting firm of Chadwick, Steinkirchner, Davis and Co, P.C., who performed audit work at Western State College.

## **Reconciliation of Work-Study Payments**

During our testing of A-133 compliance we reviewed controls over the posting of payroll transactions and over the processing of student financial aid information. The College disbursed over \$450,000 in federal and Colorado work-study funds during the fiscal year ended June 30, 2000. The amounts disbursed and posted through the payroll system are not reconciled to those posted to each student on the financial aid system. For the year ended June 30, 2000, this resulted in an initial discrepancy between the amounts over \$20,000 of federal financial aid posted on the general ledger and the amounts reflected on the financial aid office records.

Efforts by the College to reconcile this difference identified approximately \$4,000 of funds that were overawarded and were required to be returned to the federal programs. The College has taken action to return the funds to the federal government. Monthly reconciliations of work-study funds would improve controls over student financial assistance and reduce the risk of overawards occurring in the future.

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### **Recommendation No. 8:**

Western State College should implement a procedure whereby the amount disbursed for federal and Colorado work-study in the payroll system is reconciled to the amount shown as disbursed on the financial aid system. This reconciliation should be performed on a monthly basis.

### **Western State College Response:**

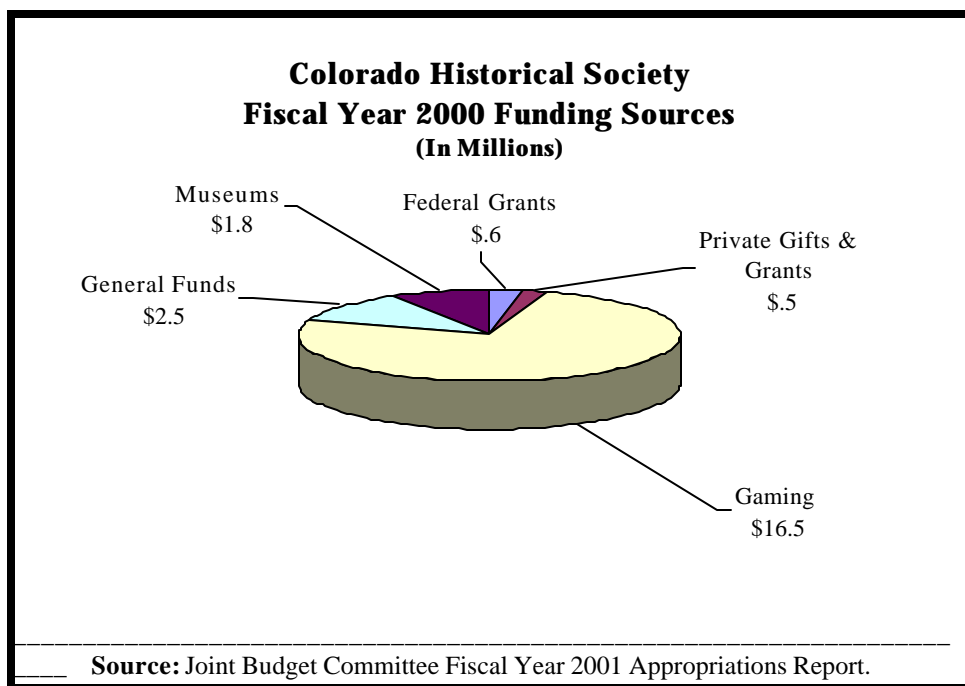
Agree.

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## **Colorado Historical Society**

The Colorado Historical Society, founded in 1879, has statutory designation as an educational institution of the State. It has exclusive control over the State's historical monuments and in this capacity has the duty to survey suitable sites and structures for historical designation by the State. The Society is charged with administration of a state register of historic properties.

During Fiscal Year 2000 the Society operated on a budget of \$21.9 million with 106.1 full-time equivalent staff (FTE). The following graph show the types of funding received by the Colorado Historical Society.



## Improve Controls Over Cash Receipts

The Colorado Historical Society operates 12 regional museums. These museums are located in the following Colorado cities: Denver, Pueblo, Fort Garland, Platteville, Georgetown, Leadville, La Jara, Trinidad, and Montrose. During our testwork we discovered two deficiencies with the cash controls in place as follows:

- **At one museum we found that cash register tapes were not being maintained.** The Byers-Evans House, one of the regional museums, recorded revenue for admissions and sales of merchandise of about \$19,000 for Fiscal Year 2000. When revenue received by the Byers-Evans House is submitted to the accounting department, an accompanying cash register tape is not submitted as a record of retail sales or admissions. During our testwork we found that 13 out of 25 transactions tested related to the Byers-Evans House. None of the transactions were supported by cash register tapes. We also discovered that similar operations within the Society did provide cash register tapes as backup for revenue submitted to the accounting department. Without documentation such as cash register tapes, there is no control to ensure that submitted revenue is correct and complete.

- **Cash reconciliations are not done properly at one museum.** The El Pueblo museum recorded entry errors made on the cash register to the over/short account rather than writing an explanation for the entry error and reconciling the cash register tape to actual cash on hand. As of May 31, 2000, there was a shortage of approximately \$900. The total revenue earned for this museum through this date was \$24,459. The over/short account represents approximately 4 percent of revenue earned by this museum. There is no evidence that voids, resulting from error, are explained and approved. When there are actual cash overages and shortages, they are also recorded in this account. Combining both the entry errors and the actual cash overages and shortages will give a misleading picture of the over/short account. It is not possible for the Society to determine whether actual cash was missing.

We reviewed the over/short accounts of all other museums and discovered that these balances, as of May 31, 2000, ranged from \$.08 under to \$1,242 over. Requiring museums to account for their actual over/short will minimize the risk that all cash is not accounted for.

The Colorado Historical Society should require cash register tapes as support for revenue, and cash reconciliation procedures at the museums. The Society may not be recording the correct amount of revenue due to the way errors on the cash register are recorded at the museums. The current practices could lead to revenue and cash being misstated.

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## **Recommendation No. 9:**

The Colorado Historical Society should:

- a. Implement a policy that requires all museums to submit cash register tapes with revenue remittances.
- b. Require museums to void sales made in error, provide an explanation for the voided transaction, and get approval to void the transaction.
- c. Determine when an actual instance of a cash over/short occurs, track these overages and underages, and perform analytical procedures to determine the extent, amount, and reasonableness of their occurrence.

## Colorado Historical Society Response:

- a. Agree. Most museums currently submit cash register tapes with deposits. The main exception has been the Byers-Evans House. However, it has never been formalized in a policy. We currently have a general procedure for all cash remittances which will be updated to include the requirement that museums shall submit cash register tapes with their revenue remittances. To be implemented by November 1, 2000.
- b. Agree. There are a few museum directors and their assistants who are not sufficiently trained on the operation of their cash registers to produce tapes that agree with their deposits. More specifically, these staff do not know how to void their duplicates. Since the turnover for the assistants is quite high due to most being seasonal employees, the Society shall develop a training program for the museum directors that also gives them the expertise to train their staff to be proficient with the cash register. To be implemented by March 1, 2001.
- c. Agree. The lack of training on the proper use of the cash register by some staff created the artificial cash over/under by their not being able to void duplicate sales entries. The training program, as outlined in response b. above, should eliminate most of the overages/underages. The Society cashier shall be made responsible for tracking, analyzing, and determining if there is an underage problem at the museum. If there is, the cashier will inform the Controller for corrective action. To be implemented by March 1, 2001.

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## Prevent Duplicate Invoice Payments

As noted earlier, the Colorado Historical Society has 12 regional museums. These museums submit their invoices for purchases of items, such as supplies, utilities, pest control, and resale items, to the Historical Society's accounting department where they are paid on the museum's behalf. On some occasions, the museums will inadvertently submit the same invoice to the accounting department for payment. The second request for payment is made with a copy of the original invoice.

During our testwork we discovered that 3 out of 25 transactions tested were for duplicate invoices. While the total dollar amount of duplicate payments was low, about \$500, the sample's incident error rate was high. It should be noted that the three vendors that received these duplicate payments returned the checks to the Historical Society. In all

three of these cases, the vendors detected the overpayments, not the Historical Society. Consequently, unless the vendors bring payment errors to the Society's attention, there is a risk that the State will not be reimbursed for erroneous payments.

A policy of paying only from original invoices, and not from copies, would prevent duplication. If duplicate payment of invoices is not controlled, expenses will be overstated and cash will be misappropriated. Some vendors may not return the duplicate payments to the Historical Society.

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### **Recommendation No. 10:**

The Colorado Historical Society should:

- a. Strengthen management controls over the processing of payment voucher transactions to prevent duplicate payments to vendors.
- b. Review all 2000 expenses for duplicate payments.

### **Colorado Historical Society Response:**

- a. Agree. The COFRS system helps avoid duplicate payments by not allowing the same invoice number to be used with another voucher. It gives you an error message. We will make sure that the accounts payable technician uses the invoice number, or if no invoice number, the invoice date to avoid duplicates in the future. Also, if the technician is paying from an invoice copy rather than the original, she will be instructed to check for a duplicate payment in a COFRS table that records recent payments by vendor, invoice number, and voucher number. To be implemented immediately.
  - b. Agree. While this will take some time and effort to discover any duplicates that may still exist, it should be beneficial to determine if the system antiduplication process is properly working or if staff is inadvertently not properly using it. To be implemented by November 15, 2000.
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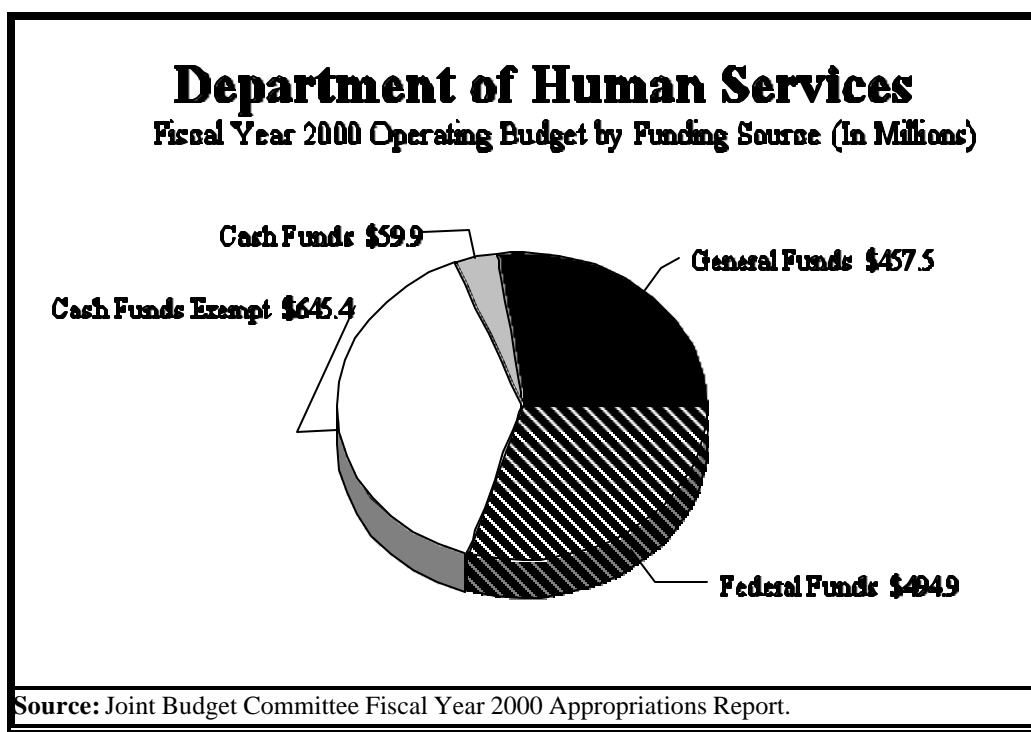
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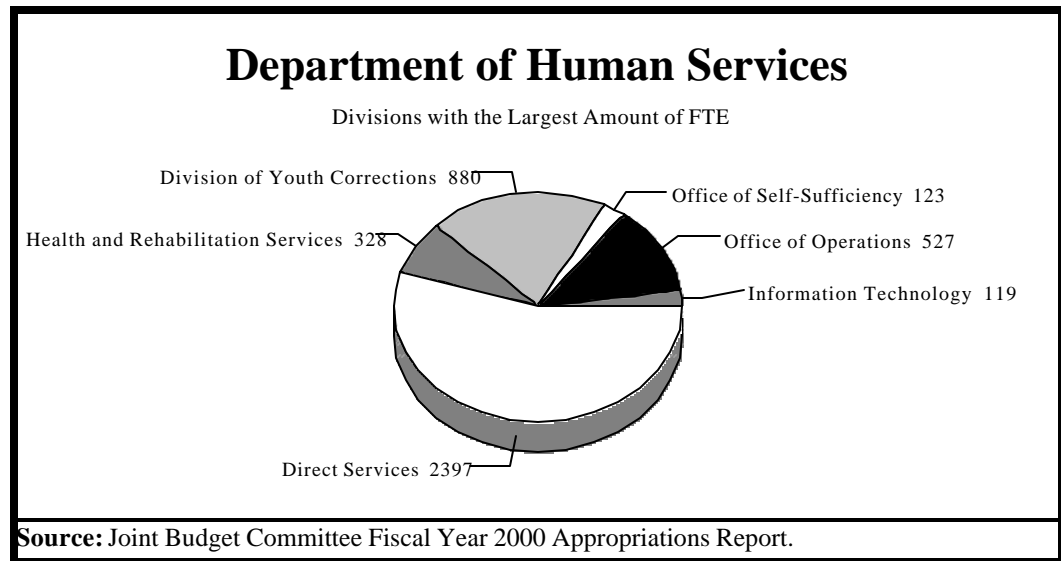
# Department of Human Services

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## Introduction

The Department of Human Services (DHS) was created on July 1, 1994, to manage, administer, oversee, and deliver human services in the State. The Department supervises the administration of the State's public assistance and welfare programs in addition to operating a number of facilities that provide direct services. Some of the programs that the Department oversees are Temporary Assistance to Needy Families, Food Stamps, Child Support Enforcement, Aid to the Needy Disabled, and Aid to the Blind. The Department's direct-care facilities include two state mental health institutes, three regional centers for persons with developmental disabilities, five state and veterans nursing homes, and ten youth corrections facilities. In Fiscal Year 2000 the Department expended approximately \$1.6 billion and had 4,695.2 full-time equivalent staff (FTE). The following charts show the operating budget by funding source and the divisions/offices with the largest FTE, respectively, for Fiscal Year 2000:





Generally, we found the Department to have adequate administrative and internal controls in place to oversee its operations and meet state and federal requirements. However, we noted that the Department needs to make improvements in ten areas to assist it in effectively managing its responsibilities.

## Improve Controls Over Purchasing Cards

Beginning in Fiscal Year 1999 the Department began the use of purchasing cards, which are credit cards issued to approved staff for making single purchases under \$3,000 for Department business. The use of purchasing cards is a statewide initiative to reduce the time and cost of purchasing. Charges made with the card are the liability of the Department unless the cardholder violates the terms of the card's use. Cardholders are responsible for reviewing monthly statements of their charges, having their approving official review and sign the statements, and maintaining supporting documentation for purchases.

During Fiscal Year 2000 the Department processed almost 12,600 purchasing card transactions that accounted for nearly \$1.9 million in expenditures. As of June 30, 2000, there were about 550 DHS employees that had departmental purchasing cards. Both procurement and accounting staff at DHS have responsibilities for overseeing the purchasing card program.



## Problems With Purchasing Card Transactions Were Noted

As part of our audit we reviewed a sample of credit card purchases made during Fiscal Year 2000. Overall, we noted at least one problem with 23 of 40 items tested, or 58 percent of the sample. Specifically, we found:

- C **Two instances in which charges were made by Department staff other than the authorized cardholder.** This is an inappropriate use of the cards. The Department should ensure employees are clearly informed that cards should not be shared and state this policy in the Purchasing Card Manual.
- C **Nine instances in which cardholders made inappropriate purchases as defined by the Purchasing Card Manual.** Eight of these transactions were for services, although the Purchasing Card Manual states that services are inappropriate purchases. However, Department accounting and procurement staff indicate that they communicate to staff during training that certain types of services may be charged on a purchasing card. Therefore, the Purchasing Card Manual is not consistent with training provided to staff.

In one additional transaction, fuel was charged on the card, although the Purchasing Card Manual states purchasing cards should not be used for this type of charge.

- C **One instance in which a cardholder circumvented the card's spending limit by splitting the purchase into three different transactions.** The purchase was split into different transactions for \$1,000, \$385, and \$500 for a total of \$1,885, while the cardholder's single purchase limit was \$1,000. The Purchasing Card Manual prohibits splitting a purchase among transactions in this manner.
- C **Six instances in which cardholders did not maintain adequate supporting documentation as required by the Purchasing Card Manual.** The Manual requires that original documentation for purchases, or a Certification of Lost Receipt form, be attached to the cardholder's monthly statement of purchases. In addition, the Manual states that receipts should be itemized with a description and quantity of each item purchased. Lack of documentation increases the risk that purchases may be made for inappropriate items.

Because cardholders had not maintained required documentation, we had to rely on cardholders' verbal descriptions of the items purchased. In two instances, we

were unable to determine if the charges were appropriate, since cardholders who made the purchases are no longer with the Department.

- C **Twenty instances in which supporting documentation did not include sufficient detail to allow us to determine the purpose of the purchases.** In these cases, although staff had maintained some supporting documentation, they did not state the purpose for the purchases—for example, the purpose for purchasing food or a camera with state monies. As a result, additional inquiries were necessary to determine that the purchases were appropriate.

The Purchasing Card Manual does not require that cardholders include the purpose of purchases as part of supporting documentation. However, employees are routinely required to state the purpose of various expenditures such as reimbursements related to travel. Information on the purpose of specific purchase card transactions should be a requirement, in order to assist individuals reviewing these purchases to determine their appropriateness.

- C **Six instances in which monthly charges were not reviewed by cardholders and/or approving officials.** The Purchasing Card Manual states that cardholder and approving official responsibilities include reviewing and signing monthly statements of charges.
- C **Twelve instances in which transaction account coding errors occurred.** Eleven transactions were charged to inappropriate object or expenditure codes, and one transaction was coded to an inappropriate appropriation code. According to the Purchasing Card Manual, each cardholder and the approving official are responsible for determining appropriateness of transaction coding and forwarding changes to accounting staff when necessary. If purchases are incorrectly coded, expenditures are not accurately recorded on COFRS.

## **Audit Process of Purchasing Cards Needs Improvement**

Our concern with the Department's controls over purchasing cards is elevated because, in addition to the above, we found that the review process performed by procurement staff at DHS of cardholder purchases is limited and not well-defined. We noted the following:

- C **Reviews are not performed routinely and limited samples were tested.** The Purchasing Card Manual states that an audit of all cardholders with transactions was scheduled for approximately one month after the program was implemented. However, due to staffing limitations, the Department did not audit any cardholders'

transactions in Fiscal Year 1999. In addition, for purchases made in Fiscal Year 2000 the Department conducted only limited audits of 20 cardholders, or approximately 3 percent of all cardholders, during the year. Also, sample purchases were tested for only two months of Fiscal Year 2000.

- C **Procedures for conducting reviews, including follow-up procedures to ensure errors identified are addressed, are not documented.** Although procurement staff developed a form for reporting the results of their audits, DHS has not documented specific steps outlining audit procedures that should be used to ensure testing is adequate and consistent, and the Department has not documented requirements for appropriate follow-up with noncompliant cardholders.
- C **Transaction account coding is not reviewed.** Department procurement staff stated that they do not have knowledge to assess the appropriateness of account coding; therefore, they do not include this as part of their audits. In addition, the Department's accounting staff indicated that they have not reviewed account coding because the cardholders and their approving officials are responsible for determining appropriateness of the coding. However, as previously mentioned, we found coding errors in 30 percent of our audit sample. This indicates that review of account coding is necessary.
- C **Cardholders do not receive disciplinary actions for noncompliance with policies and procedures.** Although the Purchasing Card Manual provides for disciplinary action in instances of noncompliance, procurement staff reported that since the program was new, they believed they should simply review purchasing card policies and procedures with cardholders found to be out of compliance during the initial stages of the program. However, instances of repeated or substantial misuse should result in stronger disciplinary actions.

Procurement staff stated that subsequent audits would entail taking disciplinary actions when necessary. Now that the program is in its third year, such actions should be taken when appropriate.

Adequate controls over purchasing cards are important, since credit cards are a high-risk area for fraud and abuse. Controls are especially important at the Department of Human Services because it administers and oversees numerous types of offices and facilities across the State and provides a broad range of services, such as operations of facilities for mentally ill individuals, persons with developmental disabilities, and at-risk juveniles; programs for welfare recipients under the Colorado Works program; and medical services

and training for individuals in vocational rehabilitation, to name only a few. The risk of inappropriate purchases is further increased if purchasing card policies and procedures are not clearly documented and consistently communicated to staff and if purchases are not routinely and sufficiently monitored.

The Department needs to take steps to improve the administration of the purchasing card program to ensure that state funds are spent appropriately. Clarifying aspects of the Purchasing Card Manual, providing additional training to cardholders, and improving the monitoring process of the program will provide the Department with greater assurance that cardholders are using purchasing cards properly.

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### **Recommendation No. 11:**

The Department of Human Services should revise the Purchasing Card Manual and conduct routine staff training on the proper use of purchasing cards to address:

- a. Prohibitions on the sharing of cards and the circumventing of spending limits.
- b. Appropriate types of services to be purchased.
- c. Required supporting documentation for purchases, including the purpose of all purchases.
- d. Responsibilities for appropriate use of account codes, including responsibility for determining the need to change account coding and communicating these changes.
- e. Requirements for reviewing and signing monthly cardholder charges by appropriate staff.

### **Department of Human Services Response:**

- a. Agree. The Department will emphasize in its Purchasing Card Manual the prohibition of splitting transactions in order to circumvent spending limits and we will revise the manual to clearly prohibit sharing of purchasing cards, our training will emphasize the prohibition of these practices.
- b. Agree. The Department will revise the manual and include in its training specific information relating to appropriate types of services.

- c. Agree. The Department will emphasize in its Purchasing Card Manual the required documentation for purchases; Department will revise the manual and include in training a requirement that a brief description of the purpose for the purchase be part of the documentation.
- d. Agree. The Department will link the Web site containing the chart of accounts and definitions on the Procurement Web site and will list the location in the Purchasing Card Manual. Department will revise the manual to address responsibilities for approving officials' giving guidance in determining when it is necessary to make accounting code changes and the process to follow for assigning proper account codes to transactions when reviewing the Statement of Account. The Department will provide training to address this.
- e. Agree. The Department will emphasize in its Purchasing Card Manual the requirement for approving officials to review and sign off on the Statement of Account for each cardholder who has purchases during the previous cycle period. The Department will also emphasize in the training.

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## **Recommendation No. 12:**

The Department of Human Services should improve the audit process for the purchasing card program by:

- a. Performing reviews on a monthly basis and selecting a representative sample of transactions or cardholders to be reviewed.
- b. Documenting audit procedures, including procedures for reviewing specific transaction account coding.
- c. Enforcing disciplinary action when necessary.

## **Department of Human Services Response:**

- a. Agree. The Department will identify a sample of monthly transactions and identify the associated approving officials. Department will then review transaction documentation to verify compliance.
- b. Agree. The Department will implement documented procedures.

- c. Agree. The Department will develop and implement procedures for compliance review noticing to office managers for follow-up of possible disciplinary action.

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## Strengthen Payroll Controls

During Fiscal Year 2000 the Department of Human Services (DHS) was the third-largest department in the State, with 4,695 FTE. DHS expended over \$196.5 million in total payroll costs, representing about 12 percent of total departmental expenditures. We reviewed the Department's payroll controls and identified areas that need improvement.

### System Problems Result in Payroll Errors

The Department of Human Services' automated timekeeping system, known as KRONOS, was implemented departmentwide in Fiscal Year 2000. This system tracks hours worked by employees and calculates pay based on enhanced hourly rates, in cases where employees work certain shifts, and overtime pay as appropriate. The Department has incorporated a bar code onto these employees' state identification badges. Employees swipe their cards through electronic time clocks at the beginning and end of their work shifts, and employees' time information is stored in KRONOS where it is available for supervisors and payroll staff to review. Employees are then paid based on the information in KRONOS.

We found that, under certain circumstances, KRONOS incorrectly classifies the hours worked by employees, and as a result, employees may be overpaid. We tested a sample of 58 payroll calculations for one month across three agencies within the Department, and we found one employee was overpaid \$4.51 in August 1999. While this is a small error, it uncovered a problem with the KRONOS system. The problem occurred because KRONOS erroneously recorded a portion of the employee's hours as overtime shift hours rather than non-overtime shift hours.

Department payroll staff said they are aware that KRONOS incorrectly classifies non-overtime hours as overtime hours in specific circumstances. The misclassification occurs when an employee charges annual leave at the end of a week in which he or she has worked overtime or a shift for which an enhanced rate is paid. In these instances, KRONOS erroneously records a portion of the hours at overtime or enhanced rates. While the Department has notified the system vendor of the problem, staff report that the

vendor has not corrected the malfunction. We also found that the Department, although it is aware of the problem, has not instituted procedures to identify and correct these errors. Thus, it is not known how many of these kinds of errors may have taken place. For the error found during our audit, payroll staff indicated that they had not identified this error or arranged for the employee to reimburse the State for the overpayment.

Although the individual payroll errors resulting from the KRONOS malfunction may not be large, there could be numerous errors. In Fiscal Year 2000 approximately 3,780 employees at the Department were eligible for overtime and enhanced pay for working different shifts.

## **Reconciliations Were Inaccurate**

In addition to timekeeping problems, we noted concerns with routine payroll reconciliations. Prior to the issuance of each payroll, Department payroll staff reconcile the expected payroll information obtained from the State's Colorado Personnel Payroll System (CPPS) with payroll information obtained from departmental sources. These sources include information from KRONOS, personnel or position changes through the Department's Office of Human Resources, or other changes affecting employees' pay. Payroll staff perform this reconciliation to ensure that the amounts generated through CPPS are accurate, prior to payment taking place.

As part of our audit testwork, we reviewed a sample of three payroll reconciliations for three divisions within the Department. For two of the divisions, we found that Department payroll staff did not always perform adequate reconciliations between internal documents and CPPS prior to the distribution of the state payroll. Specifically, we noted the following:

- C For one division with payroll expenditures over \$985,000 for August 1999, prior to providing us with the reconciliation, Department payroll staff reviewed the documentation and identified five miscalculations resulting in payment errors totaling \$260.79. Specifically, one employee was underpaid \$249.45 and two people were overpaid a total of \$11.34. In other words, payroll staff had not performed an adequate reconciliation for the August 1999 payroll to identify and correct errors until the time of our request in July 2000, almost a year after the payroll was issued.
- C For another division, with an average monthly payroll of \$5.2 million, Department payroll staff were unable to provide us with complete documentation for one reconciliation until approximately four months after we initially requested it. The division is the largest division within the Department. During the four-month time

period, Department payroll staff provided us with three different reconciliations. Two were incomplete or did not agree to actual payroll generated for selected employees, and one reconciled correctly to actual payroll generated. Payroll staff indicated that the file containing the reconciliation had been corrupted and, therefore, created several incorrect versions of the original reconciliation.

### **Improve Payroll Deficiencies**

It is essential for the Department to have strong payroll controls in place due to the magnitude and complexity of its payroll expenditures. If problems are noted with automated systems such as KRONOS, steps must be taken to compensate for these problems. In addition, routine payroll reconciliation procedures should be sufficient to enable the Department to identify errors and make appropriate corrections to data before payroll is generated. If these controls are not adequate, the Department cannot ensure that employees are paid appropriately.

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### **Recommendation No. 13:**

The Department of Human Services should ensure payroll expenditures are accurate by:

- a. Working with the vendor for KRONOS to ensure system malfunctions are corrected and all calculations affecting payroll are accurate and complete.
- b. Developing and implementing controls to compensate for miscalculations of payroll amounts in KRONOS under certain circumstances. These controls should enable the Department to identify and correct any errors prior to the issuance of payroll.
- c. Reviewing payroll generated since KRONOS implementation to identify payment errors and adjusting employees' pay, as appropriate.
- d. Performing adequate payroll reconciliations between CPPS and agency information prior to the issuance of payroll to ensure amounts paid are accurate in total and for each individual.

### **Department of Human Services Response:**

- a. Agree. The Department is working with the KRONOS vendor in an effort to identify the cause of the system malfunction and correct it or determine if corrections to the system are not feasible and then alternative measures will be employed.



- b. Agree. The Department will develop and implement procedures and reports to identify and compensate for KRONOS miscalculations if the system malfunction cannot be corrected.
- c. Agree. The Department will review payroll generated since KRONOS implementation on July 1, 1999, to identify payment errors and adjust employees' pay.
- d. Agree. The Department is strengthening payroll reconciliation procedures to ensure amounts paid are accurate in total and for each individual.

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## **Require Documentation of Supervisor Approval on Time Sheets**

In Fiscal Year 2000 the Department fully implemented a new automated timekeeping system, KRONOS. This system allows the Department to track hours worked by employees who are eligible for overtime pay and enhanced pay rates for working different shifts. The Department has incorporated a bar code onto these employees' state identification badges. Employees are required to swipe their cards through electronic time clocks at the beginning and end of their work shifts. This information is then stored in a database and is available for supervisors and payroll staff to review. The employees are then paid based on the information in the system.

We reviewed timesheets for a sample of Department employees. We found that four of ten time sheets tested, or 40 percent, did not contain documentation of supervisory approval.

State Personnel Rules require time records to be certified by both the employee and the supervisor. We also noted that Department payroll staff at the Colorado Mental Health Institute at Pueblo provided time sheets for our review that included both employee and immediate supervisor signatures.

Department staff indicated that, prior to the implementation of KRONOS, employees eligible for overtime and shift pay were required to manually complete time sheets. Supervisors then signed these time sheets to indicate the hours worked were accurate. The Department revised its procedures in Fiscal Year 2000 due to KRONOS implementation. While the new procedures state that supervisors are responsible for monitoring employees' work hours on a weekly basis, they do not require supervisors to document written approval of employee time sheets.

It is especially important for the Department to have strong internal controls in this area due to the large number of Department employees eligible for enhanced pay rates for working different shifts and the large number of Department employees eligible for overtime pay. For example, the Department expended over \$6.4 million in Fiscal Year 2000 for overtime and shift pay. Ninety-five percent, or \$6.1 million of this amount, was paid to employees at the Mental Health Institutes and the 24-hour-care facilities, where overtime and shift hours are a common occurrence. By requiring documentation of supervisory review of time sheets, the Department can ensure that payroll expenditures for overtime and shift pay are reviewed and are appropriate.

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### **Recommendation No. 14:**

The Department of Human Services should require documentation of supervisory approval on all time sheets for those employees eligible for overtime and shift pay.

#### **Department of Human Services Response:**

Agree. The Department will re-notify all supervisors of the policy requirement of supervisory approval on all time sheets for employees. The Department will review policies regarding the processing of time sheets with unit timekeepers. The Department will review, strengthen, and improve policies.

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## **Make Timely Payments to Disability Determination Services Vendors**

During Fiscal Year 2000 the Department of Human Services expended approximately \$15.7 million for the federal Social Security-Disability Insurance program (CFDA #96.001). Under this program, the Disability Determination Services (DDS) Division within the Department assists the U.S. Social Security Administration (SSA) in determining if individuals are eligible for federal disability insurance. In order to make these determinations, the Division pays physicians to perform examinations of disability insurance claimants. Examinations are needed when the medical evidence provided by the claimant's physician is inadequate.

State Fiscal Rules require payments to be processed in a timely manner. However, we found that the Department does not always make payments to providers in a timely manner. For example, we reviewed 97 payments made by DDS to vendors. We found

that 52, or 53 percent, of the payments tested were made 45 or more days after the invoice was received by DDS staff.

Department management has indicated that it is difficult to find vendors to provide services under some programs because the State pays lower rates than non-governmental entities.

Staff have expressed this specific concern in terms of finding medical providers for the Disability Determination Services program. Making payments promptly is one way in which the Department can encourage vendors to continue to do business with the State.

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### **Recommendation No. 15:**

The Department of Human Services should ensure that the Disability Determination Services Division makes payments to vendors in a timely manner.

#### **Department of Human Services Response:**

Agree. Adequate staff have been hired and trained. We plan to prevent this in the future by keeping the staffing at appropriate levels and keeping them trained. We are also implementing new procedures where other sections can assist with Accounts Payable work in an emergency situation and have trained the staff in other sections to back up Accounts Payable functions. This should provide more flexibility in the future.

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## **Mental Health Services**

The State has a unified mental health system under which eight Mental Health Assessment and Service Agencies (MHASAs) provide mental health services to all Medicaid eligibles within the MHASA's geographic service area. The state system is capitated. Under a capitated system, the State pays a flat rate to each MHASA for every Medicaid eligible in its service area, and the MHASA provides eligibles with all medically necessary mental health services.

Most people with developmental disabilities are eligible for Medicaid. As a result, they will qualify for mental health services if they have a diagnosed mental illness and treatment is medically necessary. People with both a diagnosed developmental disability and a mental illness are deemed "dually diagnosed." On the basis of data collected during our review, we estimate that about 895 people, or 29 percent of those in the comprehensive services population, are dually diagnosed.

The following comment was addressed in the *May 2000 Department of Human Services, People with Developmental Disabilities Performance Audit* report.

## **Eliminate Duplicate Funding Streams**

Our audit found that people with developmental disabilities are not always able to access mental health services through the State's mental health system. Staff at all three Regional Centers and three of four Community-Centered Boards (CCBs) interviewed reported problems obtaining needed services. Services were refused to people with developmental disabilities because, according to MHASA staff, the crisis behaviors exhibited by these people were related to their developmental disability and not their mental illness.

The Medicaid program makes capitated payments to MHASAs on behalf of all Medicaid eligibles each month. This includes 6,152 Medicaid eligible adults in both supported living and residential services statewide, of which 2,372 are served by the four CCBs and three Regional Centers in our sample area. Capitated payments for people with developmental disabilities range between \$26 and \$175 per person per month, depending on the area of the State. These payments are significant:

- Capitated payments made on behalf of people with developmental disabilities statewide will total about \$6.5 million during Fiscal Year 2000.
- Capitated payments made on behalf of people with developmental disabilities served by the four CCBs and three Regional Centers included in our review totaled \$2.6 million. Of this amount, capitated payments totaled about \$2.1 million for people served by the four CCBs and about \$452,000 for people served by Regional Centers.

In addition to these capitated payments, four CCBs, three Regional Centers, and the Developmental Disabilities Services Section (DDS) spent about \$1.5 million on services provided by mental health professionals outside of the capitated mental health system for the people in our sample area. CCBs purchase some of these services because, as we have discussed, people with developmental disabilities are frequently denied services through the mental health system. Regional Centers provide these services because their self-contained service model makes a continuum of services, including mental health services, available to all residents on-site. DDS is providing these services because expertise for providing mental health treatment to people with developmental disabilities is not available through the mental health system.

## Clarify Funding Streams for MHASAs and the Regional Centers

In the previous section we discussed duplicate funding streams for people served at the CCBs. We found the same concerns for people served by the Regional Centers.

Historically, Regional Centers have provided all of their mental health services through their own professional staff or through contracts with specialists. Regional Centers are reimbursed a per diem rate to cover all of their costs, including the costs of providing mental health services. When the Department implemented capitation in 1995, it examined mental health expenditures statewide to determine which expenditures to include in the capitation base. It included some mental health expenditures for the State Mental Health Institutes, which were also paid on a per diem basis, but according to staff, the Department specifically excluded mental health expenditures at the Regional Centers. Department staff report that the MHASAs were only expected to provide limited services, including emergency services, to Regional Center residents.

Although the Regional Center mental health dollars were not included in the capitation base, MHASA contracts are vague and do not clearly state which services MHASAs are expected to provide, and conversely, which services they are not expected to provide. Further, the Department could not provide any documentation clarifying that the MHASAs' responsibilities for serving Regional Center residents were limited. The MHASAs receive payments every month on behalf of each person residing at the Regional Centers. These payments total nearly \$452,000 per year. This means the Department has paid about \$1.8 million to MHASAs in the five years since implementing capitation, but Regional Center residents have received almost no services from the mental health system.

When the State implemented capitation for mental health services in 1995, the intent was to purchase a single, unified system for providing mental health care to Medicaid eligibles. As we have shown, the mental health system is not unified. CCBs are purchasing services outside of the mental health system because they are unable to get adequate service from MHASAs. Further, the three Regional Centers provide their own mental health services for their population of about 400 people, each of whom is eligible for mental health services through the mental health system. This fragmented approach results in a separate carve out for the Regional Centers. A carve out erodes the principle of capitation, which is to spread financial risk over the entire service population.

The Department must address duplicate funding streams for the mental health system and the Regional Centers. One option is to require the mental health system to serve all

Regional Center residents as currently required by contracts. This approach would create a single system for the provision of mental health services, avoiding a separate carve out just for the Regional Centers. Under this approach, MHASAs would likely need to locate mental health professionals at Regional Centers to meet the intensive treatment requirements of Regional Center residents. Additionally, the Regional Centers would be required to discontinue purchasing mental health services themselves. This would make funds available for other services, including serving people on waiting lists.

A second option is to permit the Regional Centers to provide their own mental health services outside of the mental health system. Under this approach, the Department should discontinue the \$452,000 per year in capitated payments made to MHASAs on behalf of Regional Center residents, since MHASAs would no longer be required to serve this population. Some of these funds should be made available to the Regional Centers for purchasing emergency services. The remaining funds could be used to serve people waiting for services. This option would allow the Regional Centers to maintain control over the mental health services provided to their residents. The Department is concerned that, under this option, it would have to increase capitation rates to compensate for dollars lost from removing the Regional Center residents from the base. However, the Regional Center residents represent less than 1 percent of the total population of eligibles in the Aid to the Needy and Disabled (AND) capitation base. Therefore, we believe that the impact on current rates would be minimal. Furthermore, MHASAs have reported savings each year, which they use to serve non-Medicaid eligibles, again indicating that removing these approximately 400 individuals from the base should not require a rate increase.

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### **Recommendation No. 16:**

The Department of Human Services should eliminate duplicate payment and service provision systems for mental health services at the Regional Centers through one of the following options:

- a. Require the mental health system to serve all Regional Center residents as required by contracts. This should include procuring all needed specialists for serving people with developmental disabilities and locating them on-site when needed. Regional Centers should discontinue purchasing their own mental health services.
- b. Allow Regional Centers to continue providing their own mental health services. Discontinue capitated payments made to MHASAs on behalf of Regional Center

residents, and provide some of these funds to Regional Centers for purchasing inpatient and emergency services.

### **Department of Human Services Response:**

Disagree. The Department believes that changing the funding of Medicaid mental health services to the developmentally disabled is not advisable. The Colorado Mental Health Capitation and Managed Care Program has, since 1995, held contractors responsible only for those mental health services that were included in the fee-for-service system. Current capitation payments to contractors include only those historical payments made for services billed using the diagnoses covered by the program and only for those services provided in an inpatient or outpatient setting. Payments made to the Regional Centers for Medicaid Mental Health Services (with the exception of emergency and inpatient services) have never been a part of the contractors' rates but were included in the all-inclusive payments made to the Regional Centers.

The Department believes that it is neither practical nor advisable to have Regional Centers discontinue the provision of their own mental health services. These services are provided primarily by experienced psychologists and social workers who are state employees at these Centers. Their services have been an integral part of the interdisciplinary team approach and include behavioral and social services which are requirements of the Intermediate Care Facility for the Mentally Retarded and Home- and Community-Based Services for people with Developmental Disabilities programs administered by the Centers.

Neither Recommendation 16a nor 16b would result in savings to the State. If MHASAs were responsible for all mental health services at the Regional Centers, those dollars for mental health services which are now in the Regional Centers' rates, would need to be transferred into the rates paid to the MHASAs. If the dollars currently in the MHASAs' rates were transferred to the Regional Centers, those dollars would need to be used for providing inpatient/emergency services and the member months for those recipients would be taken out of the MHASA pool resulting in higher rates per eligible MHASA individual.

Audited financial reports show that during the last fiscal year only one contractor has shown excess savings after allowed profit.

Shifting risk from one entity to another as proposed in the recommendations may not be actuarially sound and would be incongruous with the basic principles of

managed care and capitated payment systems. The Department will consult with the Department of Health Care Policy and Financing concerning this issue.

### ***Auditor's Addendum***

*We reemphasize that MHASAs are required by their contracts to provide all medically necessary mental health services to Regional Center residents, yet Regional Center residents have received almost no mental health services. Regional Center residents represent less than 1 percent of the Medicaid Aid to the Needy and Disabled (AND) population. The Department has not done any analysis to support its assertions that (1) Regional Center residents cannot be served within the current capitation base and (2) \$452,000 in capitated payments cannot be removed from the capitated base and transferred to the Regional Centers and developmental disabilities system without significantly impacting rates. These are funds which, if made available to the developmental disabilities system, could serve people on waiting lists. Since the inception of capitation, we have noted problems with the Department's oversight of and lack of controls over capitation savings. We have been particularly concerned that the Department ensure Medicaid recipients receive the services to which they are entitled before allowing MHASAs to accept profit or spend savings on the non-Medicaid population. These concerns continue. The Department's position that it cannot clarify mental health funding streams at the Regional Centers, as we recommend, is not based on sound financial analysis and, further, is not in the best interest of the State.*

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# Judicial Department

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## Introduction

Established by the State Constitution, the Judicial Department is a separate branch of the State's government. The Chief Justice of the Supreme Court is the head of the branch and is responsible for establishing administrative procedures for the following courts:

- Supreme Court
- Court of Appeals
- Trial Courts and Probation
  - 22 district courts
  - 62 county courts
  - 7 water courts
  - 23 probation departments
  - Denver Juvenile Court
  - Denver Probation Court

The Supreme Court includes the State Law Library, Public Defender Commission, Commission on Judicial Discipline, Judicial Nominating Commission, Board of Law Examiners, Grievance Committee, and Alternate Defense Counsel. These commissions and committees perform various functions such as maintaining the law library, investigating disciplinary actions against attorneys, providing nominees for vacant positions, and considering applications for admission to the Colorado Bar.

The Office of the State Court Administrator provides direction to the state courts and probation departments in accordance with the policies of the Chief Justice. The Office assists the courts by providing personnel, financial, planning, and information services.

Several offices and committees within the Department operate outside the direction and control of the State Court Administrator to provide services to the Judicial Department. The Office of the Public Defender provides legal representation for the indigent. The Office of the Alternate Defense Counsel, which was established in 1996, provides representation for the indigent when there is a conflict with the Public Defender representing the individual.

In Fiscal Year 2000 the Department was appropriated approximately \$242.1 million and 3,006.8 full-time equivalent staff. The Department receives approximately 81 percent of its funding from general-funded revenue.

The following comments were prepared by the public accounting firm of Grant Thornton LLP, who performed audit work for the Judicial Department.

## **Establish Performance Evaluation Policy**

Performance evaluations are completed annually for employees of the Judicial Department as a means of determining such things as compensation, promotions, and demotions. During our audit we found that a performance evaluation was performed for a contract employee.

Applying salaried employee personnel policies to contract employees could be exposing the Department to a liability. There is no guarantee that a contract employee's contract will be renewed and the Department is not required to provide a reason for deciding not to renew an employment contract. Salaried employees, on the other hand, may only be terminated if the State has a distinct cause for doing so. If a contract employee is treated in such a manner that they have a "reasonable expectation of continued employment," then they may have a case against the Department if their contract is not renewed.

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### **Recommendation No. 17:**

The Judicial Department's internal legal department should establish and distribute to supervisory personnel a written policy that includes, at a minimum:

- a. Detailed descriptions for the treatment of contract employees.
- b. Clarification that contractors are strictly governed by the individual employee's contract, and that there is a clear distinction between contract employees and salaried employees.

### **Judicial Department Response:**

Agree. Certified employees of the Colorado Judicial Department are governed by the Colorado Judicial Department Personnel Rules, while contract employees are governed by the provisions of their employment contract. Supervisors are

routinely advised not to use the formal performance appraisal process (that which is used for certified employees) for contract employees. This does not, however, preclude supervisors from giving feedback to contract employees, but it does mean that the process must be clearly differentiated. We will issue a reminder to all supervisors through the Human Resources Bulletin.

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## Segregate Duties Related to Handling Cash

The Judicial Department collects cash from a variety of fines and fees. During our audit we found that duties for collecting cash need to be separated. Controls that separate the collecting, recording, and depositing of cash minimize the risk of undetected errors or defalcations. Processes could be improved at the following offices:

**Office of the Public Defender.** The Office collects about \$60,000 annually for various fees such as attorney training. Currently the receptionist opens incoming mail and initials the associated incoming documentation to confirm that the amount received matches the amount that was due. The cash received along with the related documentation is then given to the accountant who maintains the cash receipt logbook and records the entry on the State's accounting system. The accountant also confirms that all cash receipt numbers are recorded.

The receptionist should make entries to the cash receipt logbook before handing cash and supporting documentation to the accountant, and a third individual should review the logbook to account for all cash receipt numbers and review the amount recorded on the State's accounting system. Without this control feature, the cash actually received could be different from the cash given to the accountant.

**Attorney Regulation Agencies Accounting Office (ARAAO):** About \$4 million in fees are collected annually from four sources at the ARAAO that include continuing education and Bar exam fees collected by the Board of Law Examiners and by Continuing Legal Education, fees from the ethics school, reimbursements of "costs on cases" from attorneys at the Attorney Regulation Counsel, and registration fees from the Attorney Registration Office. On a daily basis, a summary of cash collected is prepared by an individual from each of the above-stated sources. The summary and cash is given to one of the two ARAAO accountants. However, only a single individual at the ARAAO handles cash, prepares deposits, and maintains the general ledger.

The duties should be divided up between the two accountants so that the work of one person serves as a “check” on the work of the other. Procedures should be implemented to ensure that incoming cash and checks submitted to the ARAAO accountant agree to the amounts deposited in the bank account and recorded in the general ledger. The ARAAO accountant could prepare deposits and the other ARAAO accountant make general ledger journal entries based on the cash receipt reports. However, because of the limited number of personnel, rather than giving additional daily tasks to the other accountant, it may be more feasible to have the other accountant agree the daily cash receipt reports to deposits reported on the bank statement in conjunction with the monthly preparation of the bank reconciliation.

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### **Recommendation No. 18:**

The Office of the Public Defender should separate the function of preparing the cash receipts log and recording the receipt on the State’s accounting system, designate a third person to account for all cash receipt numbers, and review the amount recorded on the State’s accounting system.

#### **Office of the Public Defender Response:**

Agree. We will adopt new procedures pursuant to the recommendation.

### **Recommendation No. 19:**

The Attorney Regulation Agencies Accounting Office should segregate the duties of handling cash, preparing the deposit, and maintaining the general ledger.

#### **Attorney Regulation Agencies Accounting Office Response:**

Agree. One of our longtime employees in the accounting office left approximately two months ago. The newest member of the accounting office begins employment on October 10, 2000. When she begins her employment, we will divide the duties to ensure that one handles the cash and prepares the deposits, and the other makes the deposit and verifies all of the numbers. Until October 10, 2000, we are using non-accounting employees to verify the deposits.

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# Department of Law

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## Introduction

The Department of Law is headed by the Attorney General, who is an elected state official as provided by Article IV of the State's Constitution. The primary functions of the Department are to serve as:

- Legal counsel and advisor for all departments, commissions, boards and elected officials of state government.
- Legal representative of the public interest for all citizens of Colorado.
- Enforcement agency for the Colorado Consumer Protection Act, state and federal antitrust laws, and the Uniform Consumer Credit Code.

Also, the Department performs reviews of all state contracts for compliance with State Fiscal Rules and statutes, and provides legal opinions to all agencies of state government.

The Department of Law was appropriated total funds of \$ 32.9 million and 340.8 full-time equivalent staff (FTE) for Fiscal Year 2000. Approximately 34 percent of the funding is general-funded, 64 percent is cash-funded, and 2 percent is federally funded.

## Promptly Identify and Refund Taxpayer Overpayments

The Uniform Consumer Credit Code Division within the Department of Law protects consumer buyers, lessees, and borrowers from unfair credit practices under the Uniform Consumer Credit Code (UCCC). In order to fund, administer, and enforce the fair credit practices, lenders, such as retail credit grantors and sales finance companies, are required to self-report their total annual consumer credit sales to the Division. Payment must be submitted with a form that details the computation of the fees due. A \$10 fee for each \$100,000 of consumer credit sales and a \$10 annual notification fee are charged to the lenders. Prior to Calendar Year 2000 the fee for each \$100,000 of consumer credit sales was \$12, two dollars higher than the current year. For Fiscal Year 2000, fees collected

totaled approximately \$800,000. We noted deficiencies in the review procedures performed over the fee calculations.

During our testwork we found that 2 of the 13 transactions tested were calculated based on the 1999 rate rather than the 2000 rate. The total amount of the overpayments found was \$2,244. We found that the Division does not recalculate the payment. The Division was not aware of the overpayments and had not refunded this excess as of May 17, 2000.

The Department has procedures in place that inform the lenders of rate changes in the fees, such as a preprinted form used to calculate lender fees and the UCCC manual the lenders receive. While some procedures are in place, the discovery of these overpayments indicates the need for additional procedures to verify the accuracy of the payment. Without verification, there is the potential that future overpayments will not be detected.

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### **Recommendation No. 20:**

The Department of Law should implement review procedures for the Uniform Commercial Credit Code fee payments and refund any excess to the lenders.

### **Department of Law Response:**

Agree. The Uniform Consumer Credit Code Unit received over 4,600 forms totaling approximately \$800,000 within a two-month period in Fiscal Year 2000. The Unit provided businesses with a fee calculation form that included current rates and step-by-step instructions attempting to alleviate errors. The volume of forms, time frame for depositing funds, and shortage of staff in the UCCC made it impossible to verify every payment unless a compliance examiner was pulled from examinations for two months. This would have led to a reduced number of compliance exams, resulting in refunds of excess charges to consumers. Because the UCCC's primary purpose is consumer protection, this did not appear to be a viable option.

A change in the law, effective July 1, 2000, will reduce the number of businesses required to pay notification fees by more than half. This reduction will facilitate staff review for overpayments, allowing for overpayments to be returned before they are deposited, eliminating the need for refunds. We plan to emphasize on the cover instructions and on the calculation form that the fee structures have changed in an effort to avoid miscalculations. Review of notification payments was implemented July 1, 2000. (Note: All overpayments identified in the audit were

refunded June 20, 2000, within ten days of notification and verification of overpayment.)

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# Department of Military Affairs

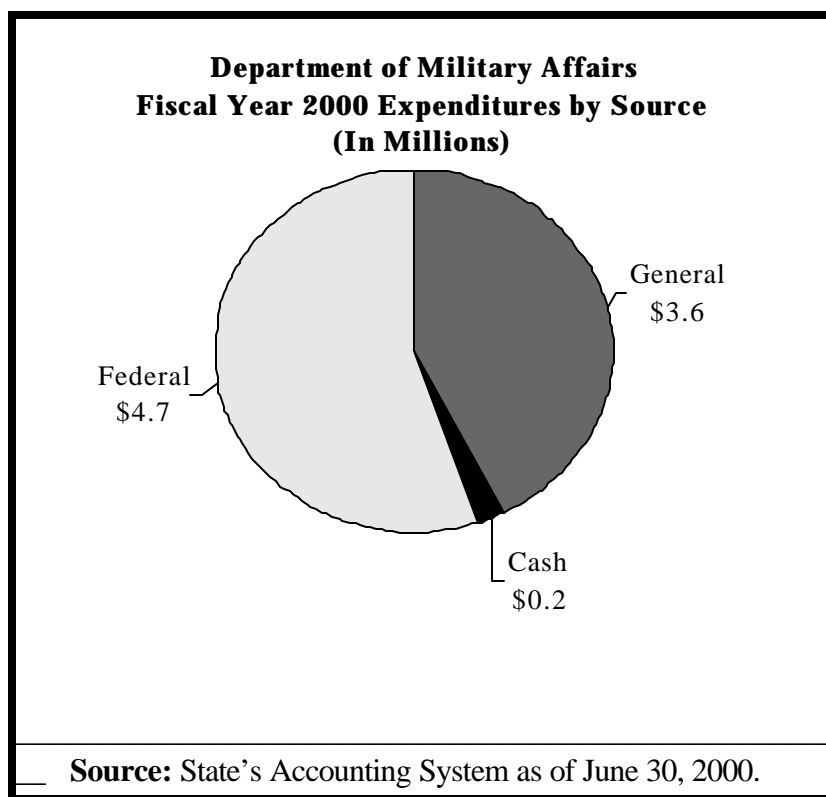
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## Introduction

The Department of Military Affairs' primary mission is to support federal, state, and local governments in the time of need. The Adjutant General is the administrative head of the Department and the Chief of Staff of the Colorado National Guard. The Department includes the following divisions:

- Executive Director's Office
- Army National Guard
- Air National Guard
- Civil Air Patrol

During Fiscal Year 2000 the Department of Military Affairs expended \$8.5 million, of which 55 percent was from federal funds, 43 percent was from general funds, and 2 percent was from cash-funded sources. In addition, the Department employed 1,309 full-time equivalent staff (FTE). The following chart shows the Department of Military Affairs' expenditures by source for Fiscal Year 2000.





## Strengthen Controls Over Accounting Functions

During Fiscal Year 2000 the Department of Military Affairs experienced a significant turnover of accounting staff and delays in replacing the vacant positions. The situation left the accounting section understaffed for the majority of the year. The State Controller's Office provided additional support to the Department in order to complete accounting transactions at fiscal year-end. However, the Department had problems completing all required transactions and providing information on a timely basis to both our office and the State Controller's Office.

The shortage of accounting staff created additional risk that transactions may have been recorded improperly on the State's accounting system. We noted that the following areas need improvement:

- The costs associated with individual construction projects were not tracked separately by the Department. During Fiscal Year 2000 construction was completed on armories and other buildings, but the costs associated with the construction were not properly reflected as a completed project on the State's accounting system. As a result, construction in progress was overstated and buildings were understated as reported in the footnotes to the financial statements. The Department was unable to determine, or provide an approximation of, the costs for completed construction projects.
- Buildings and property owned by the Department valued at \$7.9 million was transferred to the Department of Public Safety in December 1999. However, the Department of Military Affairs did not remove these assets from their records. This error resulted in an overstatement of assets in the State's financial statements by \$7.9 million.
- Utility invoices, totaling about \$61,000, from the Army Guard at Buckley were not received by the Department of Military Affairs until after fiscal year-end. These invoices were not paid until the next fiscal year; however, they relate to activities that occurred in Fiscal Year 2000. Thus, this amount should have been recorded as a liability on the State's accounting system.

As stated earlier, the State Controller's Office had to provide accounting assistance to the Department to complete accounting transactions for the fiscal year. This support would not have been necessary if the Department had cross-trained other employees to be able to perform accounting duties. The Department should provide this training so that operations of the Department can be carried out in an effective manner if staff turnover occurs in the future.

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**Recommendation No. 21:**

The Department of Military Affairs should ensure its controls over accounting functions are operational so that all transactions are recorded properly at fiscal year-end. In addition, the Department should cross-train its staff so that operations can be carried out in an effective manner during times of staff turnover.

**Department of Military Affairs Response:**

Agree. The controls that are and were in place over the accounting functions would have ensured that all transactions were recorded properly had staff been available. However, because key positions were vacated during the five months prior to closing the fiscal year, timeliness of processing transactions caused significant problems during closing. For Fiscal Year 2001 the cutoff for encumbrances will be May 15, 2001, and payables will be accrued. This, combined with stabilized and experienced staff, will result in the required improvements during next year's closing.

A major goal of the accounting section is cross-training and the goal is part of every performance plan. Our assessment is that the new personnel in the accounting section are currently at a higher level of cross-training than at any other time in the last four years.

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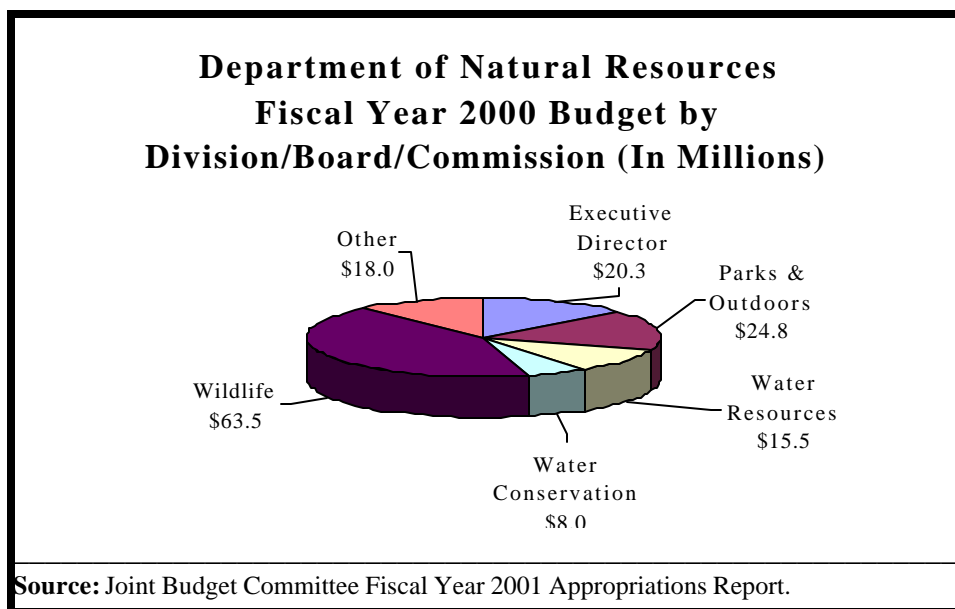
# Department of Natural Resources

## Introduction

The Department of Natural Resources is responsible for encouraging the development of the State's natural resources. Resources include land, wildlife, outdoor recreation, water, energy, and minerals. The Department operates under the authority of Section 24-1-124, C.R.S., and is composed of an Executive Director's Office and the following nine divisions:

- Division of Wildlife
- Water Resources Division
- State Board of Land Commissioners
- Soil Conservation Board
- Parks and Outdoor Recreation Division
- Oil and Gas Conservation Commission
- Division of Minerals and Geology
- Water Conservation Board
- Geological Survey

The Department's Fiscal Year 2000 operating budget was about \$150 million with 1,466 full-time equivalent staff (FTE). The Department is primarily cash-funded. Revenue sources include hunting, fishing, and other licenses; royalties and rents; interest; and other sources. The following graph shows the breakdown of funds appropriated for the Fiscal Year 2000 operating budget by division, board, and commission.



## Division of Wildlife

The Division of Wildlife is charged with protecting the wildlife of Colorado. The Division manages over 250 wildlife areas covering 300,000 acres by acquiring habitat lands, preventing the decline of certain species, conducting research, and enhancing the public's awareness of pertinent issues. The Colorado Outdoors Magazine Revolving Fund within the Division produces various videos, brochures, books, and pamphlets in an effort to promote public awareness. The nearly one and a half million hunting and fishing licenses sold annually provide the majority of the Division's funding.

### Hunting and Fishing License Issues Continue

In previous years' audits we found problems with the Division's handling of hunting and fishing licenses. During our current audit we continued to find two problems that have not yet been fully addressed by the Division. They are as follows:

- **Excess inventories of hunting and fishing licenses were being maintained by the Division.** For the Calendar Year 1998 inventory, we found that more than 300,000 licenses, or 10 percent of the total 1998 inventory, were on hand and would be destroyed. Division staff indicated they would review historical levels of licenses when ordering licenses to try to minimize excess licenses. During the current audit, we found that over 250,000 in Calendar Year 1999 licenses were still on hand at fiscal year-end and will be destroyed. Division staff should review historical license levels when ordering, to prevent waste.
- **Voided licenses were not being tracked separately from other returned licenses.** We found that the Division still does not track voided licenses separately from other returned licenses. Without a history of the number of voided licenses for each agent, it is difficult to determine whether sale receipts are being properly remitted.

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### Recommendation No. 22:

The Division of Wildlife should:

- a. Reduce excess inventories of licenses.
- b. Track voided licenses separately.

### **Division of Wildlife Response:**

- a. Agree. In 1999, 13 percent of the total license sales ordered were destroyed. This represents a 17 percent decrease in the license inventory destroyed from 1998. The Division will continue to review inventory numbers and attempt to reduce the total. However, by ordering in quantity, we are able to receive a better per unit price. If the Division orders smaller quantities, we will have the same costs with potentially an insufficient number of licenses on hand when needed.
- b. Agree. The Division is currently in the process of looking at a point-of-sale system. This system will eliminate the concern of the Division not tracking voided licenses separately from other returned licenses. The best case scenario for implementation is January 2003. As part of the legislative process, the Division anticipates knowing whether this will be feasible by June 2001. If a decision is made not to implement a point-of-sale system, the Division will examine how to proceed with this recommendation. Until this time making an attempt to track voids separately will require a tedious manual process that will likely not be accurate, cost effective, or provide information to determine potential collusion between agents and hunters.

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## **Oil and Gas Conservation Commission and Division of Minerals and Geology**

The Oil and Gas Conservation Commission (Oil and Gas) and the Division of Minerals and Geology (Minerals and Geology), both divisions within the Department of Natural Resources, are required by statute to obtain reclamation deposits from mine and well operators before they extract resources from state lands. The reclamation deposits provide assurance that mine and well operators are financially capable of reclaiming land that has been damaged when operations are completed. Some of the monetary options permitted by statute for reclamation deposits are cash bonds and certificates of deposit. Both cash bonds and certificates of deposit are held in safekeeping by the State Treasury. If the mine and well operator defaults, the deposit is then used by the Division to cover the cost of remedying any damage to the land. If the operator returns the land to its original state, the deposit is refunded to the operator.

## **Ensure That Deposits Are Properly Protected Under the Public Deposit Protection Act**

Minerals and Geology and Oil and Gas had custody of approximately \$6.2 million of certificates of deposit at June 30, 2000. The certificates range in amount from \$100 to about \$175,000 for each operator, and most are one-year certificates that are perpetually rolled over into new one-year certificates by banking institutions, until redeemed.

During our current audit we continued to note problems in the handling of certificates of deposit by Minerals and Geology and Oil and Gas. Our concerns relate to ensuring that the public funds are properly protected.

We found that certificates of deposit for Minerals and Geology and Oil and Gas were not properly protected under the Public Deposit Protection Act. The Public Deposit Protection Act (PDPA), Title 11, C.R.S., was enacted to protect deposits that either are not insured or are in excess of the insured limit of federal deposit insurance of \$100,000 for each account. PDPA requires that:

- Public monies be deposited only in banks designated as eligible public depositories. These include most of Colorado's banks.
- Banks be informed by the depositor that the funds are public monies.
- Adequate documentation be maintained by the depositor.
- Specific PDPA identification numbers be used.
- Banks maintain sufficient collateral to cover public deposits in the event a bank becomes insolvent.

PDPA specifically excludes investment firms and out-of-state banks from its coverage.

During the Fiscal Year 1998 audit, of the 25 certificates selected for testing, we found that 9 certificates, totaling \$229,000, were not held in PDPA-eligible depositories. Three of these belonged to Minerals and Geology, and six belonged to Oil and Gas. During our current audit we reviewed records provided by Minerals and Geology and Oil and Gas which indicated that a total of 41 certificates, totaling \$422,000, were not held in PDPA-eligible depositories. Ten of these certificates belonged to Minerals and Geology and 31 to Oil and Gas. Some of the 41 certificates do not mature for another two or more years.

Minerals and Geology and Oil and Gas staff stated that these certificates will be transferred to PDPA-eligible depositories upon maturity. Minerals and Geology and Oil and Gas policy allows the mine and well operators discretion to select the financial institution from which to purchase the certificate, as long as the institution is PDPA-approved.

Section 11-10.5-111(2), C.R.S., states that “any official custodian may deposit public funds in any bank which has been designated by the banking board as an eligible public depository. It is unlawful for an official custodian to deposit public funds in any other bank than one that has been so designated.” Section 11-10.5-111(4)(c), C.R.S., further states that “any official custodian who violates the provisions of this article is guilty of a misdemeanor and, upon conviction thereof, shall be punished by a fine of not less than two hundred dollars nor more than five hundred dollars, which fine shall be mandatory and may not be reimbursed nor paid by the public unit. Upon any such conviction, the court may adjudge that the official custodian be removed from public office.”

In 1993 Minerals and Geology obtained a legal opinion from the Attorney General’s Office. The Attorney General’s Office determined that reclamation deposits held by the State qualify as public monies and should be protected in the same manner as other public monies. Oil and Gas subsequently chose to rely on the Attorney General’s opinion for their own deposits.

Minerals and Geology and Oil and Gas have had seven years to comply with PDPA. As previously stated, the average certificate held by the Division matures annually and is rolled over into a new certificate perpetually until redeemed. Although requiring the certificates to be moved prior to maturity may result in lost interest for the depositors through penalties for early redemption, we are aware of at least one certificate that has rolled over since our prior audit and is still being held in a non-PDPA-eligible depository.

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### **Recommendation No. 23:**

The Oil and Gas Conservation Commission should ensure that all deposits are in compliance with statutory and other legal requirements by, at a minimum, transferring short-term certificates of deposit to eligible public depositories on their next maturity date, and developing a plan to prudently address any long-term certificates.

### **Oil and Gas Conservation Commission Response:**

Agree/Partially Implemented. In January 1999, as a result of the Fiscal Year 1998 financial audit recommendation, the Oil and Gas Conservation Commission

implemented compliance procedures to ensure that deposits are properly protected under the PDPA. Currently the Commission has 208 certificates of deposits. 177 certificates have been placed in eligible public depositories, and have been assigned PDPA numbers. The financial institutions involved have been notified of the PDPA numbers and that certificate monies are public funds. Of the 31 certificates still requiring PDPA compliance, 4 certificates have been moved to approved public depositories and 9 certificates are currently in the process of being moved to an eligible public depository. Of the 18 remaining certificates of deposit, 11 will mature and roll over in November 2001, 1 will mature and roll over in December 2001, 1 will mature and roll over in June 2002, 3 will mature and roll over in March 2003, and 2 will mature and roll over in September 2007. When the 13 certificates of deposit mature in 2001 and 2002, they will be transferred to PDPA approved financial institutions. The Oil and Gas Conservation Commission will pursue transferring the remaining 5 certificates of deposit that mature in 2003 and 2007 to PDPA approved financial institutions so that total compliance with the State Auditor's recommendation may be achieved by June of 2002.

### **Recommendation No. 24:**

The Division of Minerals and Geology should ensure that all deposits are in compliance with statutory and other legal requirements by, at a minimum, transferring short-term certificates of deposit to eligible public depositories on their next maturity date, and developing a plan to prudently address any long-term certificates.

### **Division of Minerals and Geology Response:**

Agree. The implementation date for completion of the recommendation is August 2002, which relates to the last maturity date of the certificates that need to be transferred to PDPA-eligible depositories.

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# Department of Public Safety

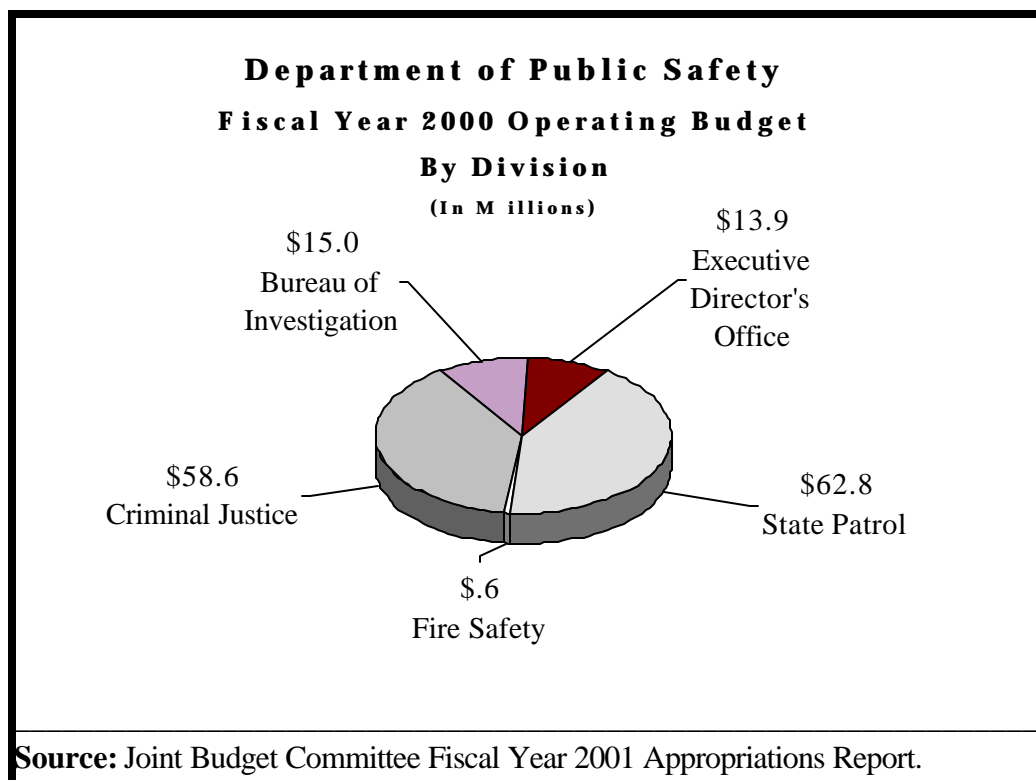
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## Introduction

The Department of Public Safety is responsible for providing a safe environment for the citizens of Colorado. The Department operates under the authority of Section 24-1-128.6, C.R.S., and is composed of an Executive Director's Office and the following four divisions:

- Colorado State Patrol
- Colorado Bureau of Investigation
- Division of Criminal Justice
- Division of Fire Safety

The Department was appropriated about \$151 million and 1,175 full-time equivalent staff (FTE) for Fiscal Year 2000. The following graph shows the operating budget by division for Fiscal Year 2000:



## **State Patrol**

The State Patrol is responsible for the safety of motor vehicle traffic on highways in Colorado. The Patrol was appropriated a budget of about \$62.8 million and 911.2 full-time equivalent staff to carry out its functions in Fiscal Year 2000.

### **Tighten Controls Over Approval of Credit Card Purchases**

The Department uses a credit card called the Procard for many of its purchases. The State Patrol is the main user of the card, accounting for 448 of the 606 credit card transactions from July 1, 1999, through June 2, 2000. Because the offices are decentralized, the local office managers are responsible for approving the expenditures. They indicate their approval by signing the receipt or monthly statement.

We selected a sample of 25 transactions and found that almost half were not approved. The problems were not specific to any particular office or manager. Some of the typical credit card expenditures reviewed consisted of cell phones charges and expenditures for office supplies. The expenditures in our sample without approval authority totaled about \$9,000. The account coding for the expenditures is input into the State's accounting system at the troop offices. At this point the invoice should be reviewed to ensure that it has been properly approved because the Department's Executive Director's Office pays the Procard bill assuming all associated invoices have been authorized. The problems noted indicate that there are not controls functioning to ensure that proper approval was obtained for each Procard purchase. Credit card purchases pose a risk to the State, unless properly reviewed and authorized, because they typically involve numerous small dollar transactions.

The local offices need to approve transactions before they are entered into the State's accounting system for payment. The Executive Director's Office should reaffirm its policies that specify what documentation should be maintained for the approval of credit card expenditures. If necessary, the Executive Director's Office should check for approval on a sample basis until it can be assured that transactions are properly approved before payment is made. Clarification and adherence to the policy would help ensure that troop offices are fully aware of their responsibilities for approving transactions and minimize the risk to the State of unauthorized expenditures.

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**Recommendation No. 25:**

The Department of Public Safety should strengthen controls over the approval of credit card expenditures by reaffirming its policies and procedures specifying the documentation that should be maintained indicating approval of credit card expenditures. Until the Department can be assured that local offices are following policy, it should sample purchases for proper authorization.

**Department of Public Safety Response:**

Agree. The Department recently implemented an electronic interface into the State's accounting system and no longer required hard copies sent in centrally. As a result, guidance in place to the field was not specifically reiterated as requiring documented approval. The Department will reaffirm its policies and procedures specifying what documentation should be maintained and properly reviewed for credit card expenditures by December 1, 2000, and we will conduct several samples to determine policy effectiveness. This will be implemented by March 31, 2001.

**Recommendation No. 26:**

The Colorado State Patrol should require its local offices to verify approvals of credit card transactions before input into the State's accounting system.

**Colorado State Patrol Response:**

Agree. The State Patrol will implement procedures so that procurement transactions are reviewed and approved on at least a monthly basis by December 1, 2000.

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**Division of Criminal Justice**

The Division of Criminal Justice's purpose is to "improve all areas of the administration of criminal justice in Colorado." The Division accomplishes this purpose through education, research, grant administration, program management, and training and support for state and local policy makers in the criminal justice system. The Division receives the majority, or

about 64 percent, of its \$58.6 million of funding from general funds, 31 percent from federal funds, and 5 percent from cash funds.

## **Salaries Charged to Federal Grants Should Be Properly Supported**

The Division administers several federal award programs with staffing costs of about \$2.7 million. Many staff, especially management, spend their time on several of the programs. OMB Circular A-87 specifies that salaries charged to federal programs must be supported by payroll activity reports. An interim allocation can be used if the allocation is reconciled quarterly to actual time records. Exception time such as annual leave, sick leave, and holiday time must be charged proportionally among federal grants if a person works on more than one grant. We found that the Division does not maintain actual time records.

Instead of actual time records, as required by federal regulations, the Division allocates time based on Division managers' monthly estimates. The estimates are then distributed to staff and, then after the fact, are reported in a monthly personnel activity report, signed by each staff person. The Division has not been reconciling quarterly, comparing actual costs to budgeted distributions, based on the monthly activity reports. We discovered that one employee was responsible for six programs but only had time allocated to three for the fiscal year through May 31, 2000. However, the Division reviewed the allocation for all employees within the Division through June 30, 2000, and concluded that allocations were consistent with actual time spent by staff on each federal program.

There were also 11 out of 20 time sheets reviewed where annual or sick leave, referred to as exception time, was not charged proportionally to grants. For the 11 time sheets with disproportionate exception time we found that 32 percent of the exception time was reported against the Byrne Formula Grant, but only 22 percent of their regular time was spent on the program. The 10 percent differential amounted to \$2,249 being overcharged to the program. Without proportionate exception time allocations, federal programs may be charged salary costs inappropriately.

The Division should develop procedures to maintain adequate time records under the requirements of OMB Circular A-87 that reflect actual time worked. Allocated time should be reconciled to actual time worked on a quarterly basis and appropriate adjustments made. Noncompliance could result in the loss of federal funding to the Division.

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### **Recommendation No. 27:**

The Division of Criminal Justice should develop procedures for tracking time worked so that salary charges to federal programs are adequately supported. Actual time worked should be recorded by personnel and then reconciled to the allocation on a quarterly basis. In addition, exception time should be prorated among federal programs in the same proportion as regular salaries.

### **Division of Criminal Justice Response:**

Agree. In addition to the current time tracking method, the Division will implement a quarterly reconciliation system and train all staff to prorate exception time accurately no later than January 1, 2001.

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## **Increase Audits of Community Corrections Vendors**

The Division has the responsibility to allocate funding to local community corrections boards, which are located in each judicial district. The funding primarily covers diversion programs and transition correctional programs. A total of \$37.9 million was recently allocated for Fiscal Year 2001. Local corrections boards select vendors to carry out corrections functions. There are currently about 35 active vendors. The Division is required by state statute to audit the vendors at least once every three years. It has developed standard guidelines that are the criteria and basis for the audits. The Division believes that this is an essential function to ensure the program is operating effectively in accordance with Division guidelines. During the course of our audit we found that vendors had not been properly audited in accordance with statutory guidelines.

Of five vendors selected in our sample, two had not had an audit within the past three years. In addition, another one of the audits included only the investigation of a specific complaint about a program that had not been otherwise audited in the prior three years. The most recent audit for two of the vendors was in 1994 and one had not been done since 1991. According to Division records, a total of about 18 vendors have not been audited within Fiscal Years 1998, 1999, or 2000. Without timely audits, there is no assurance that vendors are carrying out their functions in accordance with the Division's policies.

The Division should develop a schedule to ensure that all vendors are audited in accordance with statute during a three-year period. The Division stated that it plans to accelerate audits so that all are completed within the next two years to catch up and so that audits remain current.

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### **Recommendation No. 28:**

The Division of Criminal Justice should develop a schedule so that audits of community corrections vendors are completed at least every three years to ensure vendor compliance.

### **Division of Criminal Justice Response:**

Agree. The office has developed a two-year schedule in 1999 in order to catch up audits that were not completed during an extended vacancy in the auditor position. If the plan remains on target, audits will be current by December 31, 2001.

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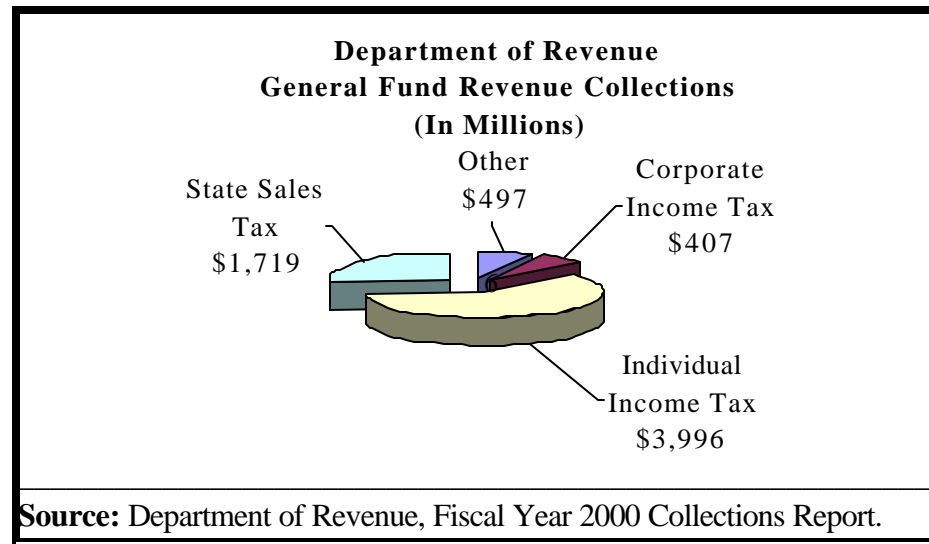
# Department of Revenue

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## Introduction

The Department of Revenue's primary role is to manage the State's tax system. In addition, the Department is responsible for performing various other functions as follows:

- Administer the State Lottery, which grossed nearly \$371 million in ticket sales in Fiscal Year 2000. Of this amount, about \$89 million was available for distribution for capital construction as well as for parks and outdoor projects.
- Act as a collection agent for city, county, RTD, special district, and severance taxes. The Department received nearly \$798 million in taxes and fees on behalf of other entities.
- Collect taxes and fees for the Highway Users Tax Fund (HUTF), which is primarily for the benefit of highway maintenance projects in the State. In Fiscal Year 2000, amounts collected for HUTF totaled approximately \$734 million.
- Regulate the limited stakes gaming activities in Cripple Creek, Black Hawk, and Central City. The gaming communities grossed about \$595 million in Fiscal Year 2000.
- Enforce tax, alcoholic beverage, motor vehicle, and emissions inspection laws.
- Operate the State's 11 Ports of Entry.



In Fiscal Year 2000 the Department had a budget of nearly \$477 million and 1,534 full-time equivalent staff (FTE). The State Lottery Division had the largest share of the budget, accounting for nearly 65 percent of the total. About 70 percent of the Department's revenue comes from cash-exempt sources such as lottery ticket sales, Highway Users Tax Fund collections, and fees charged by the Distributive Data Processing Fund, which maintains the motor vehicle registrations system. The remaining revenue is 23 percent from general funds, 6 percent from cash funds, and less than 1 percent from federal funds.

## Streamline Process for Reviewing Estimated Tax Payments

In Fiscal Year 2000 the Department collected about \$1 billion in corporate and individual estimated income taxes. Taxpayers with income from Colorado sources make estimated income tax payments throughout the year if the estimated tax liability due on their annual tax return exceeds \$1,000. Corporations must make estimated periodic tax payments if their tax liability for the year is expected to exceed \$5,000. Taxpayers who do not pay estimated taxes during the year as required may be assessed penalties and interest on the unpaid amount.

The Department's Fair Share Section has established automated edit checks to detect instances in which the taxpayer claims more estimated payments on his annual return than the Department has recorded as actual payments received. Tax examiners in the Fair Share Section review weekly reports generated from the edit program to resolve the differences. Some of these differences result from errors made by Department staff in



posting taxpayer payment information to the system and may be resolved by manual adjustments to the taxpayer's account. The Department may have to request that the taxpayer provide additional documentation of payments made or bill taxpayers for the difference if it is not attributable to errors made by the Department.

During the audit we found several deficiencies with the process of evaluating and resolving differences in amounts claimed versus amounts received, as follows:

- **Manual adjustments made to taxpayer accounts by Department staff are not adequately reviewed by supervisors.** We noted three instances of errors, totaling \$1,696, made by Fair Share staff in manually adjusting taxpayer accounts. Tax examiners review taxpayer accounts and make manual adjustments to those accounts if they determine an error was made by the Department in posting estimated tax payments. Many of these adjustments are routine and may include transferring tax amounts between tax years or between accounts of spouses or parent/subsidiary accounts. Further, it is the Department's informal policy to review and approve all manual adjustments to accounts. There was no evidence that these three adjustments were reviewed and approved by a supervisor. As of the end of fieldwork, these errors had not yet been corrected.
- **Follow-up on inquiry letters sent to taxpayers is not automated.** Inquiry letters are sent to taxpayers prior to billing, requesting additional documentation or information on payments made. Generally, a response is requested within 30 days. Unwritten policy in Fair Share requires the tax examiner to retain a copy of all letters sent to taxpayers and review the outstanding letters monthly. We noted 6 instances out of 60 in which the tax examiner sent a letter of inquiry to the taxpayer but did not follow up to determine if a response was received by the Department. Automating follow-up on inquiry letters so that the tax examiners are alerted electronically when a response has not been received by a certain date would minimize the risk that issues are not resolved. Because the process is not automated and copies of the letters may not have been retained, it is not possible to determine to what extent follow-up may not have been completed. Without adequate follow-up procedures, additional taxes may be owed but not collected.
- **Use of cancellation codes may impair follow-up on taxpayer accounts.** Cancellation codes are used by tax examiners to temporarily remove or "cancel" all items on the edit report. Normally, for other divisions within the Department, amounts owed are billed automatically within two weeks by the Department's accounts receivable system. The cancellation codes allow Fair Share staff time to investigate and possibly resolve discrepancies before a billing is generated. We

noted 2 instances out of 78, totaling \$2,325, in which a tax examiner cancelled an account on the system, but did not follow up with an inquiry letter, bill, or a manual adjustment to correct the account until the matter was brought to their attention through our audit. When the temporary cancellations are not removed, the account will not appear on the next weekly report, and thus may not be resolved. Again, because this is a manual process, it is not possible to determine how many accounts may have been cancelled and subsequent action not taken.

- **A report of taxpayer deficiency notices pending approval is run only once per year.** As noted earlier, a notice is generated automatically if a cancellation code is not placed on the account. If the account is canceled, tax examiners must manually request a bill to be sent. However, the billing must first be reviewed and approved by a supervisor in the Fair Share Section. For Fiscal Year 2000 the report of bills pending approval to be sent is only generated once a year. Of the two bills in our testwork requiring approval, we noted one instance, totaling \$24,681 in taxes owed, in which a bill was not sent to a taxpayer for over four months because it was awaiting supervisory approval. More frequent generation and review of the report would help ensure that bills are sent to taxpayers on a timely basis.

Under the current system, time is spent by Fair Share staff manually tracking the progress and status of accounts. Manual processes could result in a failure to complete follow-up. In addition, without adequate review, there is a risk that adjustments are being made erroneously. Improvements would ultimately result in a more efficient and effective process for resolving discrepancies in estimated taxes.

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## **Recommendation No. 29:**

The Department of Revenue needs to evaluate its policies and procedures related to estimated tax payments and streamline the process by:

- a. Reviewing manual adjustments made to taxpayer accounts to ensure accuracy.
- b. Automating the method of following up on inquiry letters sent to taxpayers to ensure timely response.
- c. Developing controls over the use of cancellation codes to ensure that accounts that have been cancelled on the system are resolved correctly and in an appropriate and timely manner.

- d. Reviewing reports of pending deficiency notices more frequently to ensure taxpayers are billed in a timely manner.

### **Department of Revenue Response:**

- a. Agree. The section will now record all Fair Share documents going to processing. A Tax Examiner IV will report their findings to the section supervisor who will perform this verification process. They will verify the posting of the documents and create a report detailing all accounts that did not post correctly. Implemented November 3, 2000.
- b. Agree. The section will modify and utilize the current protest tracking system to perform this function. The system has been modified to allow a supervisor to input a hold on a taxpayer's account. This will allow additional time for the taxpayer to respond without being billed. It will also allow the supervisor the ability to track and report to the examiners any response greater than thirty days. Implemented November 3, 2000.
- c. The section will allow the examiner to cancel an inquiry that is awaiting further action by the taxpayer, but a supervisor will review all cancellations. The supervisor will then place the record into the protest tracking system that will require a response within thirty days. Implemented November 3, 2000.
- d. Agree. Monthly reports of all accounts waiting for a billing approval will now be created and distributed. Implemented November 3, 2000.

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## **Strengthen Controls Over the Issuance of Earned Income Credits**

The State refunded \$25.3 million of the State's excess revenue in Fiscal Year 2000 through earned income credits. The credits were available for the first time in Fiscal Year 2000 and are allowed to eligible individuals in addition to the regular TABOR refund. The credit is designed to assist low-income households that have federal adjusted gross income of \$30,850 or less and equals 8.5 percent of the federal earned income credit. During our testwork we found controls lacking over the review of these credits.

The Department designed one edit to detect errors in the amount of earned income credit claimed by the taxpayer. The edit was designed to reject returns when the earned income credit exceeded the maximum allowable amount of \$324. This amount is based on 8.5 percent of the maximum allowable federal credit of \$3,816. The Department indicated that this control did not function properly resulting in a number of taxpayers receiving a refund larger than they were entitled to. Of 60 tax returns sampled, we found:

- **5 returns that were calculated incorrectly.** We found some taxpayers used 85 percent instead of 8.5 percent in the calculation, failed to prorate for part-year residency, and used the federal earned income credit. In our sample the 5 returns that were inaccurate resulted in over-refunds totaling \$1,353. Had the edit been functioning properly, all of these errors would have been detected before the refund was issued for the incorrect amount.
- **27 returns did not include the required Colorado Individual Credit Schedule.** The credit schedule shows the amount of the federal earned income credit, which is the basis for the state credit. The Department's instructions require the supplemental schedule and the return is incomplete without it, but the Department will go ahead and process the return if the schedule is not submitted. Without the credit schedule, it is not possible for the Department to determine whether or not the state credit claimed is accurate.

The Department processed earned income credits by relying on a single edit that did not function properly. In addition, no one reviewed the Colorado Individual Credit Schedule. This resulted in a number of taxpayers receiving refunds for which they were not entitled. To correct the system failure, the Department subsequently reviewed all earned income credit refunds in excess of \$324 and billed about 60 taxpayers that originally received incorrect refunds. The Department might have a difficult time collecting all the overpayments, since the majority of the taxpayers that qualified for the credit are low-income Colorado residents.

The Department should have implemented controls to ensure the accuracy of the earned income credit reported by taxpayers. This could have been accomplished through more thorough testing of the edit before it was placed into operation. In addition, because the Department did not request the required Colorado Individual Credit Schedule, the Department essentially processed incomplete returns. If the schedule is not provided by the taxpayer, the Department should not process the return or should evaluate other methods of independently verifying the accuracy of the credit. These controls would have lessened the risk of the earned income credits being refunded improperly.

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### **Recommendation No. 30:**

The Department of Revenue should ensure that earned income credits are accurate by:

- a. Testing that its edits for rejecting tax returns for earned income credits are functioning correctly.
- b. Processing only complete returns, or evaluating methods of ensuring that accurate credits are claimed should the taxpayer fail to submit the required schedule.

### **Department of Revenue Response:**

- a. Agree. The earned income credit is scheduled to be included in testing during the December system test.
- b. Agree. The earned income credit computations will all be checked against federal information for accuracy as part of a Fairshare project. In addition, all electronically filed returns include schedule 104CR automatically as a requirement for claiming the earned income credit.

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## **Improve the Processing of Estate Tax Installment Payments**

An estate tax return is required to be filed with the Department if the gross amount of the estate is valued at more than \$650,000. The tax return and full payment is due nine months after the date of death unless the filer elects to defer payment of part or all taxes due and pay in installments. The installment terms allowed by the Department are either 10 or 15 years, and installment payments are due annually on the same date the original return was due. The Department's Taxpayer Services Section is responsible for ensuring that estate tax installment payments are paid timely and processed and recorded accurately. At June 30, 2000, installment tax payments due the Department totaled about \$2.5 million.

Interest is charged on any tax due that is not paid by the due date. Thus, installment payments, if elected, are subject to interest calculated on estate taxes owed, at the full rate of interest, which is the prime rate of interest plus 3 percent. If payment is made within 30

days of the due date, a discounted interest rate is applicable that is 3 percent less than the full rate.

During our testwork of 5 out of 18 estate tax files, we noted that the processing of installment payments of estate taxes is a very manual, labor-intensive process, involving periodic staff review of files and manual calculations of payment amounts. We noted that there are no written policies and procedures governing the processing and review of installment payments, resulting in the following deficiencies:

- **Inadequate follow-up to ensure late filers are timely billed.** Payment information is entered onto a separate estate tax computer system. Manually calculated interest amounts are also added annually to estate tax principal in the decedent's account on the computer system. Interest is calculated at the discounted interest rate because the Department assumes that the taxpayer will pay timely. If a payment is not received within 30 days of the due date, Department staff recalculate the interest due at the full rate of interest, but do not bill the taxpayer for the additional interest until the next annual installment payment.
- **Lack of an automatic or other method for identifying late payment or non-payment of installments and for calculating interest.** Since the estate tax system is not connected to, or part of, the Department's accounts receivable system, AARAPS, there is no on-line means of determining if a payment was paid late or not paid at all. Instead, manual reviews of decedent files are performed by Department staff. No policies or procedures exist to specify how often file reviews must be performed.
- **Manual calculations of installment payments of principal and interest with no supervisory review to ensure accuracy.** Interest on the installment payments is currently calculated manually on handwritten columnar spreadsheets maintained in the decedent's file. No supervisory review is performed of the manual calculations of installment payments due. The Department's computer system has spreadsheet capabilities. However, staff do not utilize the system to calculate installment payments. If manual calculations continue, the Department should review the calculations because there is a greater risk of error than if the calculations were automated.

During our testwork we found that one estate has not remitted an annual payment since August 1997, even though the estate still owed \$6,700 in estate tax, plus interest. Including interest calculated through August 2000, the estate owed the Department \$8,582

in estate tax and interest, according to Department records. On the basis of auditors' inquiries, the Department finally billed the estate's executor for the entire \$8,582 in August 2000, and received a partial payment of \$3,000 in October 2000.

Automation of processing estate tax installment payments and establishment of policies and procedures will reduce the potential for error and require less intervention from Department staff.

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### **Recommendation No. 31:**

The Department of Revenue should develop written policies and procedures for processing and reviewing estate tax installment payments to include, at a minimum:

- a. Consistent, uniform follow-up by Department staff to ensure that billings to late filers are timely.
- b. Establishment of an automatic or other method for identifying late payment or non-payment of installments.
- c. A requirement that interest and principal be automatically calculated and reviewed by a supervisor to ensure accuracy.

### **Department of Revenue Response:**

- a. Agree. A new tracking system has been developed in conjunction with new procedures on dealing with the installment agreements. Implemented in September 2000.
  - b. Agree. The use of an automated system (AARAPS) for tracking these accounts was pursued, but the system could not be reasonably adapted to accept the unique situations that are required by the estate tax laws, particularly considering the small number of accounts involved. However, a manual spreadsheet to track the installment payments has been developed and built into the Department's new procedures. Implemented October 1, 2000.
  - c. Agree. The new procedure includes use of the PRZA (mainframe sub-program) and a review of all interest charges by a reviewer. Implemented in September 2000.
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## **Computations of Tax Conferee Accruals Are Not Reviewed**

The Tax Conferee Section is part of the Department of Revenue's Tax Group. The Section is responsible for handling disputes when there is disagreement between the Department and the taxpayer in interpreting tax law. In Fiscal Year 2000 the Tax Conferee Section resolved 366 tax cases resulting in collections of about \$8.3 million and refunds of about \$5 million.

The Tax Conferee Section prepares accruals or estimates of the amounts they expect to collect and pay. This information is used to record revenue, receivables, and payables on the State's accounting system. During the audit we found errors in the schedules prepared by Tax Conferee staff for determining receivable and payable tax accruals. We noted that the tabulation was not reviewed by a supervisor. In addition, it appears that spreadsheets are not linked, so amounts do not automatically carry over to other spreadsheets. The more significant errors affecting the Department's accrual calculation are as follows:

- One error resulting in deferred revenue (revenue that is not expected to be collected by the Department for at least a year) being understated by \$5 million.
- Two errors resulting in accrued taxes payable being understated by \$99,383.
- One error resulting in accrued taxes receivable being overstated by \$143,903.

These posting errors were the result of staff's carrying forward incorrect amounts to summary schedules, or failing to change prior year amounts to current year amounts.

Although the Department ultimately corrected the errors when they were brought to its attention through the audit process, a review would have detected the errors in a timely manner before the information was released to the accounting section for input into the State's accounting system. The review of the calculations by a supervisor or other staff in the Tax Conferee Section is important to ensure that amounts are mathematically accurate and agree to supporting documentation. In addition, linking spreadsheets allows for more accurate carryover of amounts from one spreadsheet to another.



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## **Recommendation No. 32:**

The Department of Revenue's Tax Conferee Section should improve its tabulation process for recording revenue, payables, and receivables in the State's accounting system by:

- a. Requiring that schedules prepared for determining receivable and payable tax assessment accruals be reviewed by a supervisor or other staff person in the Tax Conferee Section.
- b. Linking detailed spreadsheets to summary spreadsheets to minimize the risk of carrying over inaccurate amounts from the detailed schedule.

## **Department of Revenue Response:**

- a. Agree. The supervisor or another coworker will review the schedules to detect and reduce errors. Implementation date June 30, 2001.
- b. Partially agree. Linking may alleviate some inaccuracies; however, in some cases linking can generate errors. There is no guarantee of 100 percent accuracy. The spreadsheets will be linked for the next reporting cycle where possible without risking an increase of errors. Implementation date June 30, 2001.

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## **Improve Methodology for Estimating Wage Withholding Tax Accruals**

Each year the Department records the estimated amount of wage withholding taxes owed by taxpayers as of June 30 but not yet remitted to the Department. The process is known as the tax accrual process. The Department accrued about \$160.1 million in wage withholding tax for Fiscal Year 2000. The accrual normally increases or decreases due to a variety of factors including employment rates.

During our audit we found that the methodology used by the Department may cause significant artificial fluctuations in the wage withholding accruals because the methodology does not consistently reflect taxes received after year-end for wages earned as of year-end. A means of determining what activity is attributable to what time period is a basic concept underlying financial reporting. Without a means to determine an estimate of tax

revenue on wages earned through June 30, the Department is not providing fundamental information required by accounting standards.

There are two parts to the development of accounting estimates. The first part is the application of the accrual methodology used by the Department. This includes the review and approval of the sources of relevant data, evaluation of the reasonableness of assumptions, and consideration of changes in previously established methodology. The second part is to evaluate the methodology; that is, to compare the estimate with subsequent results to assess the reliability of the estimating process.

The Department does not consistently include wages earned through June 30 in its accrual calculation for frequent filers. Frequent filers are those taxpayers who have a large enough tax liability that they are required to submit tax returns either weekly or biweekly. The Department calculates the accrual based on the end date of the filing period instead of the amounts attributable to days worked through June 30. For example, if wage withholding payments were made for the week ending on June 30, the entire amount would be included in the accrual because the end date of the pay period was in June. However, if the pay period for the week ended on July 3, none of the payment would have been included in the accrual, even though four days would have been attributable to June. Inconsistencies can occur from year to year simply due to the timing of the end of the pay period. While there has been no TABOR impact, the methodology may cause significant variations in reported revenue from one year to another. Without using a wage withholding methodology that always accrues taxes through June 30, the Department is lacking basic financial information to consistently calculate income tax revenue.

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### **Recommendation No. 33:**

The Department of Revenue should improve its existing wage withholding accrual methodology so that it is consistently accruing taxes through June 30.

### **Department of Revenue Response:**

Agree. This recommendation applies to wage withholding accounts classified as “frequent filers.” Tax returns with payroll periods that bridge more than one month do not separately report the portion of payroll withholding liability that corresponds to the end of a specific month. In order to accrue a full June liability for these filers, the development of an allocation methodology would be required to account for any missing days in June. However, there are difficulties in developing an allocation methodology due to the lack of homogeneity among taxpayers. Difficulties include variations among taxpayers in days of operation during a payroll

cycle, the length of payroll cycles, and the commingling of multiple payroll cycles on one return.

The Department will meet and consult with the Office of State Planning and Budgeting, Legislative Council and the State Controller's Office to develop a wage withholding accrual methodology that will consistently accrue taxes through June 30.

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# Office of the State Treasurer

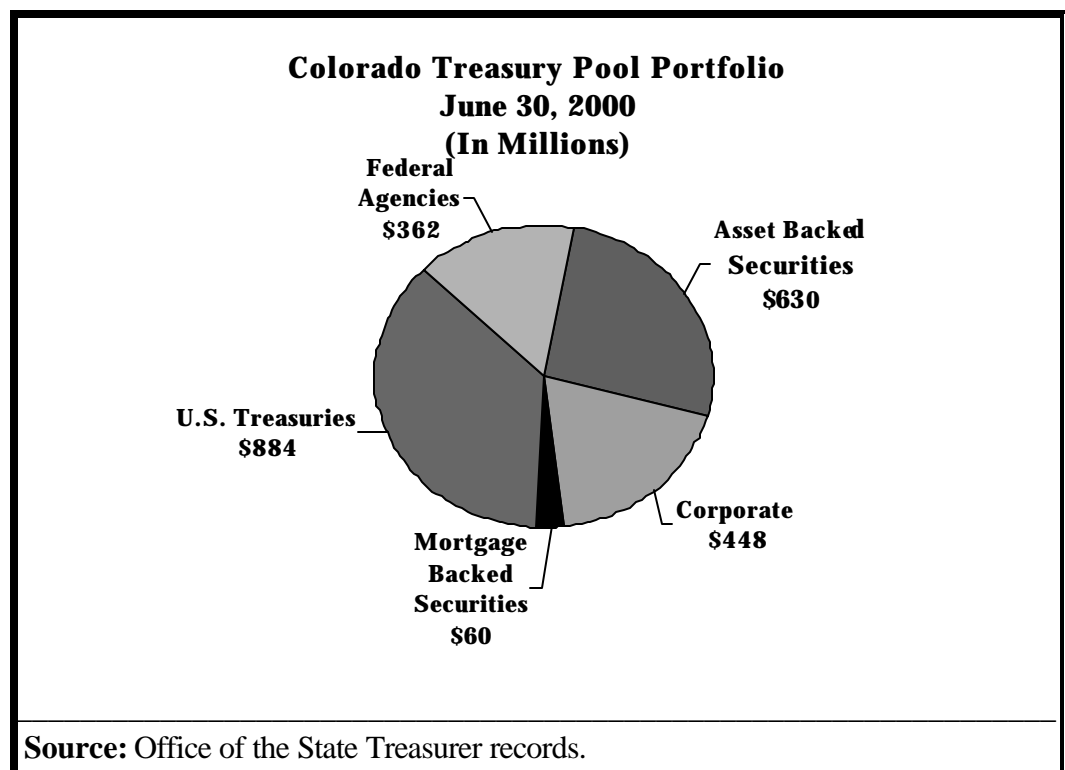
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## Introduction

The Office of the State Treasurer is established by the State Constitution and is responsible for efficiently managing the State's monies. The Treasurer is an elected official who serves a four-year term. The Office manages the State's investments, and implements and monitors the State's cash management procedures. Other duties and responsibilities include:

- Receiving, managing, and disbursing the State's cash.
- Safekeeping the State's securities and certificates of deposit.
- Managing the State's Unclaimed Property Program, the School District Loan Program, and the Elderly Property-Tax Deferral Program.

The State's pooled investments are made up of a variety of securities as shown in the following graph:



## Compliance With Colorado Funds Management Act

The Colorado Funds Management Act (the Act), (Section 24-75-901, C.R.S.), was enacted to allow the State to finance temporary cash flow deficits caused by fluctuations in revenue and expenditures. Under the Act, the State Treasurer is authorized to sell Tax and Revenue Anticipation Notes (TRANS). TRANS are short-term notes payable from the future anticipated pledged revenue.

The Office of the State Auditor reviews information relating to tax and revenue anticipation notes and reports this information to the General Assembly as directed by Section 24-75-914, C.R.S. This report section provides information about the July 5, 2000, issuance of \$150 million in General Fund Tax and Revenue Anticipation Notes (hereafter referred to as the Series 2000A Notes) and the October 2, 2000, issuance of \$250 million in General Fund Tax and Revenue Anticipation Notes (hereafter referred to as the Series 2000B notes.)

### Terms and Price

Both series of Notes have a maturity date of June 27, 2001, and are not subject to redemption prior to maturity. This date complies with the Act, which requires the maturity date to be at least three days prior to the end of the fiscal year of issue. The following table provides other details of the terms and price.

| <b>Details of Series 2000A and 2000B Note Issues</b>  |                                |
|---|--------------------------------|
| Issue Amount: 2000A<br>2000B                          | \$150,000,000<br>\$250,000,000 |
| Denomination (Both Series)                            | \$5,000                        |
| Premium on Sale: 2000A<br>2000B                       | \$ 875,259<br>\$1,207,734      |
| Face Interest Rate: 2000A<br>2000B                    | 4.75%<br>5.00%<br>5.00%        |
| Average Interest Cost to the State:<br>2000A<br>2000B | 4.353%<br>4.295%               |
| <b>Source:</b> Office of the State Treasurer records. |                                |

## **Security and Source of Payment**

In accordance with the Act, principal and interest on the Series 2000A and 2000B Notes are payable solely from any cash income or other cash receipts recorded in the General Fund for Fiscal Year 2001. General Fund cash receipts include those that are subject to appropriation in Fiscal Year 2001 and any pledged revenue, including the following:

- Revenue not yet recorded in the General Fund at the date the Notes were issued.
- Any unexpended Note proceeds.
- Proceeds of internal borrowing from other state funds recorded in the General Fund.

The State Controller will record monies reserved to pay the principal and interest of the Notes in the Series 2000 Note Payment Account (Account). The holders of the Notes are secured by an exclusive first lien on assets in the account. The State Treasurer holds, in custody, the assets in the Series 2000 Note Account.

If the balance in the Account on June 15, 2001, is less than the principal and interest of the Notes due at maturity, the Treasurer must deposit into it all General Fund revenue then available and borrow from other state funds until the balance meets the required level.

The amount due at maturity for Series 2000A is \$157,260,000, consisting of the Note principal of \$150,000,000 and interest of \$7,260,000. The amount due at maturity for Series 2000B is \$259,201,389, consisting of the Note principal of 250,000,000 and interest of \$9,201,389. To ensure the payment of the Series 2000A and 2000B Notes, the Treasurer has agreed to deposit pledged revenue into the Account so that the balance on June 15, 2001, will be no less than the amount to be repaid. The Note agreement also provides remedies for holders of the Notes in the event of default.

## **Legal Opinion**

Kutak Rock LLP, bond counsel, have stated that, in their opinion:

- The State has the power to issue the Notes and carry out the provisions of the Note agreement.
- The Series 2000A and 2000B Notes are legal, binding, secured obligations of the State.

- Interest on the Notes is exempt from taxation by the United States government and by the State of Colorado.

## **Investments**

Both the Colorado Funds Management Act and the Series 2000A and Series 2000B Note agreements allow the Treasurer to invest the funds in the Account in eligible investments until they are needed for Note repayment. Interest amounts earned on the investments are credited back to the Account. The State Treasurer is authorized to invest the funds in a variety of long-term and short-term securities according to Article 36 of Title 24, C.R.S. Further, Section 24-75-910, C.R.S., of the Funds Management Act states that the Treasurer may:

- Invest the proceeds of the Notes in any securities that are legal investments for the fund from which the Notes are payable.
- Deposit the proceeds in any eligible public depository.

## **Purpose of the Issue and Use of Proceeds**

The Notes are being issued to fund the State's anticipated General Fund cash flow shortfalls during the fiscal year ending June 30, 2001. The proceeds of the sale of the Notes were deposited in the State's General Fund. Note proceeds will be used to alleviate temporary cash flow shortfalls and to finance the State's daily operations in anticipation of taxes and other revenue to be received later in Fiscal Year 2001.

## **Additional Information**

The Notes were issued through a competitive sale. A competitive sale involves a bid process in which notes are sold to bidders offering the lowest interest rate.

The Notes issuance is subject to the Internal Revenue Service's (IRS) arbitrage requirements. In general, arbitrage is defined as the difference between the interest earned by investing the Note proceeds and the interest paid on the borrowing. In addition, if the State meets the IRS safe harbor rules, the State is allowed to earn and keep this arbitrage amount. The Department of Treasury is responsible for monitoring compliance with the arbitrage requirements to ensure that the State will not be liable for an arbitrage rebate.

## State Expenses

There are expenses incurred by the State that are directly associated with the issuance and redemption of the TRANS. These expenses include:

- Bond legal counsel fees and reimbursement of related expenses incurred by the bond counsel.
- Disclosure counsel fees and expenses.
- Fees paid to rating agencies for services.
- Costs of printing and distributing preliminary and final offering statements and the actual notes.
- Travel costs of state employees associated with note issuance and selection of a financial advisor.
- Redemption costs, consisting of fees and costs paid to agents to destroy the redeemed securities.

The above expenses were approximately \$74,000 for Series 2000A and \$80,000 for Series 2000B.

No recommendation is made in this area.